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Politics this week

Jan 26th 2006
From The Economist print edition

AP

Palestinians voted, for the first time since 1996, to elect a parliament, with the Islamist movement, Hamas, competing for the first time ever in a national poll against Fatah, the secular group that has hitherto dominated Palestinian politics. Preliminary results suggested that Hamas was beating Fatah. See article

The **Iraqi** electoral commission ratified the results of December's general election, giving the main Islamist Shia coalition 128 seats in the 275-member parliament and the Kurdish alliance 53. The combined total was just short of the two-thirds majority required to endorse a presidential council as a step on the way to forming a government. Negotiations with the two main Sunni Arab groups, which together won 55 seats, began in earnest. See article

The trial of **Saddam Hussein** was again postponed, until January 29th, after a row over the appointment of a new head of the five-man panel trying him.

With bloodshed continuing in Sudan's western province of Darfur, the 53-country **African Union** (AU) decided not to appoint Sudan's president, Omar al-Bashir, as the body's chairman. Instead, it gave the job for a year to the president of Congo-Brazzaville, Denis Sassou-Nguesso, who first took power in a coup in 1979.

The AU is to ask a panel of “eminent African jurists” to recommend where and how Hissène Habré, a former dictator of **Chad** exiled in Senegal, should be tried. Senegal referred the matter to the AU after a Belgian judge asked for Mr Habré's extradition to face charges of crimes against humanity under Belgium's “universal jurisdiction” law.

The leader of one of **Côte d'Ivoire's** main opposition parties, Alassane Dramane Ouattara, returned home after three years in exile, a week after several days of riots and attacks against UN installations by young backers of the president, Laurent Gbagbo, whose government controls only the southern half of his turbulent country.

An internal review of the **United Nations'** peacekeeping procurement operations found “substantial evidence” of fraud and abuse amounting to over $200m. Eight UN employees, including its procurement chief, were put on paid leave pending investigation.

Kosovo's succession

AFP

The death of **Kosovo's** president, Ibrahim Rugova, cast a shadow over negotiations between the Kosovo Albanians and Serbia about the province's future. A first round of talks was postponed.

Spain's prime minister, José Luis Rodríguez Zapatero, reached a provisional agreement on the text of a new constitutional statute demanded by **Catalonia**. But the opposition People's Party is fiercely against the plan, on the ground that it could lead to the dismemberment of Spain.

Aníbal Cavaco Silva became the first centre-right candidate to win **Portugal's presidency** since 1974. Mr Cavaco Silva, who was the Portuguese prime minister between 1985 and 1995, beat a clutch of left-wing candidates, including the veteran Mário Soares, who guided Portugal to democracy after 1974. See article

A squabble broke out between **Russia and Georgia** after bombs severed gas pipelines and electricity links between the two countries. Russia also accused British embassy staff in Moscow of spying and helping non-governmental organisations. See article

Turkey proposed a plan to end the isolation of **northern Cyprus**. But the Greek-Cypriot government in the south dismissed it as offering no new ideas. See article

An issue of national security

George Bush vigorously attacked critics who claim his authorisation of domestic **eavesdropping** is illegal, before visiting the National Security Agency, which conducted the programme. Karl Rove, Mr Bush's chief political adviser, told Republicans that the issue would be crucial in this year's mid-term elections.

The Senate Judiciary Committee, voting on party lines, approved **Samuel Alito's** nomination to the Supreme Court. Judge Alito is expected to be confirmed when the whole Senate votes on the matter. See article

Lawrence Franklin, a former analyst at the Defence Department, was sentenced to 12 years in prison for passing **government secrets** to two employees of the American Israel Public Affairs Committee, a lobbying group, and an Israeli official. Mr Franklin is expected to testify against the lobbyists at their trial in April.

Right a little

A federal election in **Canada** produced a rightward nudge, as Stephen Harper's Conservatives ended 12 years of Liberal rule. But the Conservatives won only 124 of the 308 seats in the House of Commons, presaging a second consecutive minority government. Paul Martin, the defeated prime minister, resigned as Liberal Party leader. See article

AP

Fidel Castro organised a march by hundreds of thousands past the United States' mission in Havana, in protest at the installation by American diplomats of an illuminated panel that displays democratic messages.

Evo Morales, **Bolivia's** new president, named a cabinet composed mainly of activists from left-wing social movements. He signed agreements with Hugo Chávez, under which Venezuela will swap diesel and political advice for soya and chicken. But he also called for an anti-drug alliance with the

United States. See article

The wife and three of the children of Augusto Pinochet, **Chile's** former dictator, were freed on bail after being charged with tax evasion. Lucía Pinochet, the general's eldest daughter, fled to Washington, DC, where she reportedly sought asylum.

Arms twisting

America warned **India** that a move to allow civilian nuclear co-operation between the two countries could be blocked by Congress if India does not support moves to refer Iran to the UN Security Council for its nuclear programme.

The prime minister of **Cambodia**, Hun Sen, dropped defamation charges against four activists who criticised him, after international and domestic pressure.

The **Mongolian** parliament chose Miyeegombo Enkhbold, a former mayor of Ulan Bator, the country's capital, as the new prime minister.

There were clashes between armed police and demonstrators in Katmandu, the capital of **Nepal**. But the government later lifted its curfew and partially restored telecoms links it had cut before a recent protest. See article

———————————————

Correction: The late emir of Kuwait, Sheikh Jaber al-Sabah, died in Kuwait, not—as we wrote last week—in Saudi Arabia. Apologies

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Business this week

Jan 26th 2006
From The Economist print edition

Walt Disney agreed to buy **Pixar** in a deal worth $7.4 billion. The move gives Pixar, the animation studio behind blockbusters such as “The Incredibles”, creative control over Disney's cartoon studios. Steve Jobs, Pixar's founder and chief executive (and also Apple Computer's boss) will join Disney's board and become its biggest individual shareholder with a 6.5% stake. See article

Boston Scientific's $27 billion offer won the bidding war for **Guidant**, a medical-device maker, after **Johnson & Johnson** confirmed it would not raise its bid again. J&J's initial offer of $25.4 billion was accepted by Guidant in December 2004, but J&J's doubts led to a renegotiation over Guidant's market value following product recalls (more were announced this week).

Albertson's, an American supermarket group that has struggled of late against discount retailers, was bought by a consortium in a deal worth around $9.8 billion. Albertson's businesses are to be divided, with the lion's share going to **Supervalu**, which will become America's second-biggest food retailer.

Several large institutional investors in **Vodafone** called on the company to boost its flagging share price by selling its 45% stake in Verizon Wireless, a big American operator. Vodafone's boss, Arun Sarin, hinted that he might one day dispose of the holding, worth up to £25 billion ($45 billion), but not yet. See article

Trying to keep the wheels on

Ford unveiled its long-awaited restructuring plan. The company will close 14 plants and cut up to 30,000 jobs (25% of its North American workforce) over the next six years. The carmaker also reported that net income in 2005 had fallen by 43% (to $2 billion) compared with 2004. Its North American operations made a pre-tax loss of $1.6 billion.

Meanwhile, **DaimlerChrysler's** new boss, Dieter Zetsche, announced the elimination of 6,000 white-collar jobs (mostly in Germany) over the next three years.

Kirk Kerkorian bought back the shares in **General Motors** he recently sold, which restores his stake in the carmaker to 9.9%. GM's woes continued when it reported a dismal loss for 2005.

Dofasco, a Canadian steelmaker, accepted Arcelor's (third) takeover offer of C$5.6 billion ($4.9 billion). Based in Luxembourg, Arcelor beat off competition from **ThyssenKrupp**, a German rival, to buy Dofasco, a big supplier to North America's car industry.

See no evil, speak no evil?

Google said it had voluntarily agreed to censor politically sensitive websites in China when it launches an internet service in the country. The approach is similar to that of other internet companies operating in China. See article

McDonald's announced plans to speed up a share buy-back programme and to offload some of its loss-making outlets as franchises, and also reported a 53% rise in net profit for the fourth quarter, compared with a year ago. An activist hedge fund said it would now end its campaign pushing McDonald's to sell its wholly owned restaurants.

Bank of America said net profit had dropped by 2% in the fourth quarter, compared with a year earlier, its first quarterly profit fall in more than four years (profit for 2005 was up by 19%). The firm, along with other big American banks that have reported disappointing quarterly results, blamed the decline on the surge in personal bankruptcies that preceded tougher bankruptcy laws last October. See article

Donald Trump launched a lawsuit seeking $5 billion in damages against both the author and publisher of a book that claims the property tycoon and reality-TV star is not a multi-billionaire but has a paltry net worth of $250m.

P&O's board accepted a £3.5 billion ($6.3 billion) takeover bid from PSA, a Singaporean port operator that is owned by Temasek Holdings, the Singapore government's investment company. A bidding war with Dubai's DP **World**, which made an offer for P&O late last year, is expected.

British Nuclear Fuels, owned by the British government, confirmed that **Toshiba** had won an auction for **Westinghouse**, BNFL's American power-plant business. The deal is reported to be worth $5 billion. Toshiba's victory in the hotly contested process puts it in prime position to take advantage of China's nuclear-energy market, where Westinghouse is already busy. See article

Feeling much better

German business confidence is at its highest for almost six years, according to Ifo, a think-tank. An improvement in the country's economic performance and surging exports also fed a rise in business optimism about the future. Analysts think the news increases the chance of another rise in interest rates.

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Elections in Palestine

Enter Hamas

Jan 26th 2006
From The Economist print edition

Now more than ever, Israelis and Palestinians need the world's help

AFP

NO MATTER whether they have actually won, the mere fact that the Islamists of Hamas were taking part in this week's Palestinian elections marks a perilous new turn in the history of the conflict in Palestine. If Israel could not make peace with a secular national-liberation movement such as Yasser Arafat's Palestine Liberation Organisation, what hope of dealing with a radical Islamic movement that is rooted in the ideology of the Muslim Brotherhood? Fear of radical Islam was one reason for Yitzhak Rabin's decision in 1993 to allow Mr Arafat and the PLO to return from exile to the occupied West Bank and Gaza. Rabin hoped to make peace with the nationalists before the rise of radical Islam made compromise impossible. On the face of it, that strategy has now failed.

New democrats, old anti-Semites

The Hamas charter calls on Islam to “obliterate” Israel, rules out negotiation and says no part of historic Palestine can ever be given up. Citing the Protocols of the Elders of Zion, a notorious forgery, it blames Jewish money for the French revolution, the communist revolution and the first and second world wars. Though claiming kinship with the PLO, Hamas opposed the founding of the Palestinian Authority (PA) under the Oslo accords, together with all subsequent attempts to negotiate a two-state solution. It has spent the past decade—long before the eruption of the recent *intifada*—conducting suicide bombings against Israeli civilians. A series of these on the eve of Israel's 1996 election was designed, successfully, to ensure that Shimon Peres, a Labour dove, lost power to a hawkish Likud under Binyamin Netanyahu.

Following this week's election, Hamas will for the first time have members in the Palestinian

parliament, and perhaps even control it (see article). That, many people will say, is what democracy is all about, and therefore a good thing. Hamas is genuinely popular among Palestinians both for its fight against Israel and for being largely free of the corruption that riddles the PA. Since Arafat's death and the hapless performance of his successor, Mahmoud Abbas, the PA has anyway been a feeble creature, incapable of fulfilling its obligations under the international "road map", such as disarming terrorist organisations. Bringing Hamas inside the tent will at least make the PA representative—and so, perhaps, more effective.

Effective, though, at what? Certainly not at disarming the terrorist organisations: Hamas is itself the foremost of those and has already refused to put aside its weapons. Arguably, it will make the PA more effective at government, especially in the chaotic Gaza strip, where since Israel's withdrawal last summer Hamas has shown far more discipline than Fatah, its nationalist rival. The main question, however, is whether Hamas in power will support peace negotiations with Israel or, staying loyal to its charter, resume suicide bombings and rule out talking altogether.

Here the evidence is mixed. In the run-up to the election, Hamas has shown a more moderate side, emphasising its record in education and welfare, and abating its threats to obliterate the Jewish state. Some of its leaders have hinted at the possibility of talking to Israel, even of a long-term truce that might one day solidify into peace. To the extent that this reflects genuine pragmatism rather than electioneering, it should be encouraged. It is worth recalling that the PLO was also once committed to Israel's destruction. It was brought into diplomacy by a process of conditional dialogue: in return for a seat at the table Mr Arafat accepted the principle of a two-state solution and forswore violence. So long as Israel and the world are strict about those conditions, nothing is to be lost by seeing whether the same strategy can work with the Islamists.

But there are two problems. One is that Hamas may be tempted to copy Hizbullah, the Islamists in Lebanon, who have found a way to have their cake and eat it too. Hizbullah leaders sit as elected representatives in Lebanon's parliament but maintain their private army and still vow to destroy Israel. Another is that many Palestinians, especially those in Hamas, are liable to be unexcited by the offer of a place at the peace table in return for good behaviour. As in Israel, the "peace process" initiated by the apparent Rabin-Arafat breakthrough in 1993 has ended in disillusion. Many Palestinians doubt that endless talking can earn them a state, given Israel's unending settlement-building in the West Bank and Gaza. And given unending Palestinian violence, many Israelis wonder whether the Palestinians really accept Israel's permanence.

Put flesh on that vision, Mr Bush

Winning converts for peaceful dialogue will therefore require some serious international diplomacy, of which there has been almost none since the collapse of Bill Clinton's Camp David summit more than five years ago. Mr Bush has a "vision" of an independent Palestine. But how big? And what about Jerusalem and refugees? In the so-called road map, the emphasis is on gradualism: step-by-step measures culminating in further negotiation, with neither side ever knowing what sort of deal to expect at the end of it all. The defect of this approach is that moderates on each side have to persuade their respective camps to trust in the good intentions of the other side. And both camps have ample reasons to withhold that trust.

The moderates now need something much more tangible to sell: not a process but a destination on which the outside world has put its definitive imprimatur. The basis for just this exists in the "parameters" Mr Clinton proposed after Camp David: a Palestinian state in Gaza plus 95% or so of the West Bank; a shared capital in Jerusalem; Palestinian sovereignty over the Temple Mount; Israeli sovereignty over the western wall; and a right for Palestinian refugees to return to the West Bank and Gaza but not to pre-1967 Israel. Mr Bush should make these his own and let the "quartet" (America, Russia, the European Union and the United Nations) throw its official weight

behind them. Once Israelis and Palestinians are told the true price of peace, there will be an outcry in both camps. But they need to know at some time what peace will look like, and cost. A majority might then be willing to vote for it.

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Health care

America's headache

Jan 26th 2006
From The Economist print edition

How to start fixing the world's costliest health-care system

EVERYONE, it seems, has a health problem. After pouring billions into the National Health Service, Britons moan about dirty hospitals, long waits and wasted money. In Germany the new chancellor, Angela Merkel, is under fire for suggesting changing the financing of its health system. Canada's new Conservative prime minister, Stephen Harper, made a big fuss during the election about reducing the country's lengthy medical queues. Across the rich world, affluence, ageing and advancing technology are driving up health spending faster than income.

But nowhere has a bigger health problem than America. Soaring medical bills are squeezing wages, swelling the ranks of the uninsured and pushing huge firms and perhaps even the government towards bankruptcy. Ford's announcement this week that it would cut up to 30,000 jobs by 2012 was as much a sign of its “legacy” health-care costs as of the ills of the car industry. Pushed by polls that show health care is one of his main domestic problems and by forecasts showing that the retiring baby-boomers will crush the government's finances, George Bush is expected to unveil a reform plan in next week's state-of-the-union address.

America's health system is unlike any other. The United States spends 16% of its GDP on health, around twice the rich-country average, equivalent to $6,280 for every American each year. Yet it is the only rich country that does not guarantee universal health coverage. Thanks to an accident of history, most Americans receive health insurance through their employer, with the government picking up the bill for the poor (through Medicaid) and the elderly (Medicare).

This curious hybrid certainly has its strengths. Americans have more choice than anybody else, and their health-care system is much more innovative. Europeans' bills could be much higher if American medicine were not doing much of their R&D for them. But there are also huge

weaknesses. The one most often cited—especially by foreigners—is the army of uninsured. Some 46m Americans do not have cover. In many cases that is out of choice and, if they fall seriously ill, hospitals have to treat them. But it is still deeply unequal. And there are also appalling inefficiencies: by some measures, 30% of American health spending is wasted.

Then there is the question of state support. Many Americans decry the “socialised medicine” of Canada and Europe. In fact, even if much of the administration is done privately, around 60% of America's health-care bill ends up being met by the government (thanks in part to huge tax subsidies that prop up the employer-based system). Proportionately, the American state already spends as much on health as the OECD average, and that share is set to grow as the baby-boomers run up their Medicare bills and ever more employers duck out of providing health-care coverage. America is, in effect, heading towards a version of socialised medicine by default.

Is there a better way? Even a glance around the world shows that there is no such thing as a perfect health-care system: every country treads an uneasy compromise between trying to harness market forces and using government cash to ensure some degree of equity. Health care is also the part of the public sector where market forces have had the most limited success: it is plagued by distorted incentives and information failures. To begin with, most health-care decisions are made by patients and doctors, but paid for by someone else. There is also the problem of selection: private-sector insurers may be tempted to weed out the chronically ill and the old, who account for most of the cost of health care.

In the longer term, America, like this adamantly pro-market newspaper, may have no choice other than to accept a more overtly European-style system. In such a scheme, the government would pay for a mandated insurance system, but leave the provision of care to a mix of public and private providers. Rather than copying Europe's distorting payroll taxes, the basic insurance package would be paid for directly by government, though that cash might be raised by a “hypothecated” tax which would make the cost of health care more evident. The amount of cash given to insurers would take account of individual health risks, thus reducing insurers' incentives to compete by taking only the healthiest patients.

Such a system would not be perfect but it could mitigate the worst inequities in America's health-care system, while retaining its strengths. In practice, however, it will not happen soon. American politicians are still scarred by the failure of Hillary Clinton's huge health-care plan (which tried in 1993 to force companies to insure workers). Incremental change, of the sort that Mr Bush is talking about, looks the only way forward.

In fact, there are plenty of incremental changes that could help, especially when it comes to curbing costs. America's health industry is already experimenting with new ways to improve efficiency (see article). As the biggest buyer, the federal government has plenty of power to push for “pay for performance”. And many of Mr Bush's mooted reforms make sense, such as limiting absurd medical litigation claims, deregulating the stifling state-based insurance market and making insurance policies more portable.

Plastic surgery may work for a while

But there is a flaw at the heart of his proposal. Mr Bush goes straight to one of the biggest distortions in American health care—the generous tax subsidies doled out to firms providing insurance. These help to promote a culture where costs do not matter. But his prescription is the wrong one. Rather than reducing this distortion, which would force firms and employees to be more cost-conscious and free up money to be spent on bringing more people into the system, the president wants to even things out by doling out yet more tax subsidies to others—for instance, letting individuals set more of their out-of-pocket medical expenses against taxes. Such hand-outs

may have political appeal, but they will worsen the budget deficit and, most probably, drive up the pace of medical spending. America's health-care system could be improved in small steps. But those steps need to be in the right direction.

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Google

Searching for integrity

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Search engines are guardians of online freedom and privacy—and depend on users' trust

INTERNET users across the world bombard search engines with roughly half a billion queries each day. Google and its counterparts are the funnel and filter of the online world. Yet the potency that makes searches invaluable to citizens, also makes them irresistible to their governments. In the past few days communist China and capitalist America have, in their own ways, challenged their independence.

This week, Google announced it is establishing a presence in China, with the opening of Google.cn (previously, users logged on to Chinese-language versions of Google.com). This will help users by placing computer-servers in China (see article), but it will thereby place Google squarely within range of the Chinese government. A few days earlier America's Department of Justice (DoJ) asked a court to enforce a subpoena against Google, requiring the search engine to hand over swathes of anonymous information about the search terms of its users, so that the government might test the effectiveness of software filters to block pornography.

As predictably as searching for “Paris” turns up the heiress to a hotel fortune, so critics pounced on Google's craven concessions to China and on the justice department's heavy-handedness. In their different ways, both governments were toying with the very ideals of free speech and transparency that the internet, according to its early myths, holds most dear. Perhaps. But the past few weeks hold another lesson, too: that, by and large, search engines look after their users—and for the best of reasons, their own self-interest.

Google has not entirely capitulated in China. It has pared back the services it offers—no e-mail accounts, for example—so that it doesn't put itself in the position where it might have to violate users' privacy. It has also arranged to tell users when search results have been withheld—though

the Chinese authorities could always reconsider the arrangement. At the same time, in America, Google has taken a healthy stand against the DoJ, refusing to give the government what it seeks.

Google's rivals have been more accommodating. Yahoo! last year revealed the identity of a Chinese e-mail account-holder, who is now in prison for exposing information the government wanted kept secret. Microsoft's MSN service prohibits words such as “democracy” from being used as headlines on Chinese blogs. In America, AOL, MSN and Yahoo! all handed their data over to the justice department.

Yet western firms faced with engagement or isolation are right to think that being in China leads to greater openness than if they stayed away. Indeed, the very controversies that have cropped up about censorship and suppression are symptomatic of the ways in which free speech is greater now than in the past, thanks to the internet. And, so long as the DoJ's data is anonymous, privacy is not strictly in question.

I'm feeling lucky

But trust is—and the best reason for thinking search engines will look after users is that their business depends upon users' trust. Among Google's reasons for not divulging data to the DoJ is that this would harm its business by fostering a perception that it might treat customer information with less than the utmost care. As befits their roles as gatekeepers of cyberspace and safe keepers of personal information, the companies know they must be trustworthy stewards of information. Users expect nothing less. Rivals are only a click away.

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Company pensions

Time for a reality check

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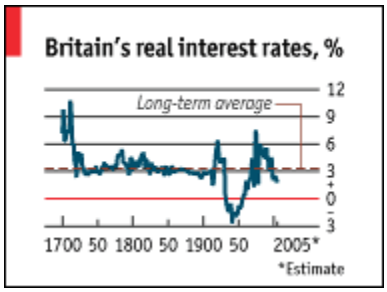
Don't be fooled: the pensions mess cannot be fixed overnight



EVERY week seems to bring yet more woe to companies and members of their final-salary (defined-benefit) pension schemes. In America and Britain the battered sector has seen funds closing in droves. From 2000-03, falling equity markets sent many funds tumbling into deficit. Since then, demand for bonds has pushed real yields steadily lower, so that even as shares have recovered, stated pension liabilities have increased faster. Funds face a mass of new regulations, especially in Britain. No wonder that companies are tempted to wash their hands of any future commitments.

How useful, then, that a solution appears to be at hand. In recent months there has been growing interest in a strategy designed to hedge away some of the biggest risks (principally those of inflation and interest rates) facing pension funds. Focusing on liabilities, rather than on assets as in the past, and building on radical new thinking by actuaries (see article), "Liability Driven Investing" (LDI) seems to offer a way of securing funds' ability to meet their cashflow needs for the next 50 years. Given the scale of the collective black hole—anything from £40 billion-300 billion ($70 billion-530 billion) in Britain alone, depending on the measure—LDI might seem an attractive way to tackle the problem. Last September WH Smith, a British retailer, undertook the most radical such strategy to date, selling all of its shares and bonds and investing the £870m proceeds in a portfolio of swaps and equity options. Not only did that make the pension scheme much more secure for its members, but the ensuing financial clarity has arguably saved the entire company from insolvency.

Such is the allure of LDI that strong demand for long-dated bonds and other instruments has begun to distort prices. A long-term trend of declining real bond yields, which pushes up annuity prices and increases the current cost of future pension liabilities, has accelerated of late. This has come against a background of louder calls from pension funds for long-duration bonds, which have cashflows that can offset future payments to pensioners. But the well-meant process of making pension funds secure has been becoming ever more expensive. If that continues, companies will surely become even more reluctant to stick with their defined-benefit schemes.

Here today, gone tomorrow

The danger of LDI is that it induces a sense that the pensions problem can be overcome with a bit of slick financial engineering. Alas, it is not so easy. Strategies to reduce risk can be effective, but they can also be costly and unnecessary—a fund with a financially strong sponsoring company or with security over assets in the event that the sponsor gets into trouble might not need to lock in a solution to today's liabilities at today's historically high prices. If pension funds all rush down the

same route, they will only compound their problems.

Better to stand back and take a longer-term view. LDI is welcome, but not a panacea to be swallowed at any price. Today's real yields, although they are low and could yet go lower, are likely to be much fatter a decade from now. Higher real interest rates would reverse at least part of the mark-to-market horror of funds' liabilities. And both governments and companies can play their part in making them come about.

The powerful long-term shift by pensions towards bonds will keep the pressure on yields for a while. America has $7 trillion of pension assets, so a 10% move towards bonds would represent a swing of around $700 billion—yet there are only some $500 billion of long-dated American Treasury bonds and about the same again of high-grade non-government bonds. Hence, another salve for the pensions crisis would be for governments and companies to take advantage of low borrowing costs and issue a lot more longer-dated debt. That would also be good for taxpayers, who would benefit by refinancing costlier debt at today's bargain prices. Until that begins to happen, funds would be better off holding cash than chasing today's expensive bonds to ever greater heights.

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Kenya

Voting out corruption

Jan 26th 2006
From The Economist print edition

Inspiring Kenyans to demand better government than Mwai Kibaki is giving them

AFP

GUESS what? Another African government, having stirred great hopes for change, turns out disastrously. Investigations by John Githongo, an expert on graft and a former correspondent for *The Economist*, suggest that the government of Mwai Kibaki in Kenya is as corrupt as the kleptocratic regime of Daniel arap Moi that it replaced (see article). Mr Githongo had been hired by Mr Kibaki to combat graft, but fled Kenya last year after receiving death threats. As newspapers in Kenya reported this week, he claims to have discovered ministers looting millions of dollars. They allegedly told him the money was needed to ensure success in elections.

As false dawns go, Mr Kibaki's government had looked particularly rosy-fingered. It came to power in 2002 by tapping enthusiasm for democracy and reform. For once united, poor Kenyans, from a panoply of tribes, voted out a party that had ruled them ruinously since independence in 1963. Mr Kibaki declared a war on corruption, and his first shots told. Crooked judges and heads of state-run companies were sacked. An investigation began into a complicated scam of the early 1990s, the Goldenberg affair, in which perhaps a billion dollars were lost. Kenyans embraced the change. A decrease in petty corruption was recorded across the country. After a minister found a bag of cash in his office, it was rumoured, he rushed to return it to the businessman who had left it there.

Yet the old cycle soon resumed. Petty graft rebounded. Mr Kibaki stopped denouncing corruption. An official report on the Goldenberg affair has not yet been published. Mr Kibaki's ministers, after all, had learned their trade under Mr Moi's tribally-divisive regime. They appear to have entered politics to make money for themselves and their hangers-on. When they reached the trough, they gorged. In an effort to remain there, they gorged more. None expected Mr Githongo to object.

After all, he is a member of the president's own tribe.

But Mr Kibaki's government ignored a fatal flaw in the political method of Mr Moi. His regime was eventually voted out. Mr Kibaki took his own, less serious, rebuke recently, in a referendum on a draft constitution that would have shored up his powers. Before the vote, his supporters cast their bribes freely. But Kenyans still voted no.

It was not always so. In the 1990s, when multi-party democracy was reintroduced to Kenya after a long pause, Mr Moi's party won two elections through rigging and by inciting the tribes to fight each other. To foot the bill, top-level corruption boomed. Thousands were killed in tribal clashes. But Kenyans now understand democracy better. Mobile phones and private radio stations have given them a freer voice. A robust free press, including the newspaper that published Mr Githongo's allegations, has also helped. A growing urban middle class is more determined to hold leaders to account.

Kenya has changed, and its politicians need to change too. In response to the latest allegations, Kenya's anti-corruption authority, a toothless investigative body that has not instigated a notable conviction, has summoned 30 officials. To restore his reputation, Mr Kibaki should award it prosecutorial powers. Any minister or civil servant involved in graft must be sacked. Mr Githongo should be welcomed back to Kenya, his security assured, to give an open account of his investigations. Failing this, Mr Kibaki can expect Kenyans to dismiss him at an election due next year. A new opposition alliance is already waiting. Naturally, it pledges to fight corruption.

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British schools

Let us hope

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From The Economist print edition

Why Tony Blair's education reforms are (just) worth it

Reuters

IN 1861, a national education commission proposed that the state should provide a “sound and cheap” elementary education for the masses. You'd think that Britain might have managed that in a century and a half, but it's arguable. A quarter of all children leave primary school unable to read and write, the OECD blames low British productivity on the badly educated workers at the bottom of the pile, and since 1997 spending on education has gone up in real terms by 45%, without much to show for it.

That's at least in part because when Labour came to power in 1997, it thought the answer was to stop fiddling with the system and focus on “standards, not structures”. Schools were to be examined and ranked relentlessly, advisers to be sent to underperforming schools, and teachers to be trained and given “continuous professional development”, but the way the system was organised was to be left largely alone. Since then, the government has come to realise that it was busy digging a money pit; unreformed institutions can soak up any amount of cash and have very little to show for it. And now, belatedly, it is attempting structural change.

Too good for the market

The measure of any reform is whether it goes in the right direction, and how far. What should be the aim of an education system? Well, that old commission got it fairly right. First, education should be universal, which means it must at least in part be paid for by the state. Second, it should be “sound”, though one might prefer a more enthusiastically 21st-century description (“high-quality”, “fulfilling the aspirations of the nation's children”, that sort of thing). Third, it

should be, if not cheap, at least cost-effective, which means that some discipline has to be applied to ensure that it uses its state funding well. All else (including the question of whether private money or private providers should be involved) is ideology.

Yet Britons, usually a rather unideological people, are curiously dogmatic when it comes to education. Many otherwise quite liberal people believe that private education should be outlawed. The idea of private providers educating children—even when that education is paid for by the state—is widely regarded as unacceptable, as is the notion of using the discipline of the market to get value for money for taxpayers, to reward successful schools and to punish failing ones. Despite the government's failure to use central control to spend its money better for pupils, many politicians find the idea of schools behaving like companies and parents like customers distasteful. Education, it is widely felt, is a high-minded business that should not be treated as though it were mere commerce.

Other countries have no qualms in handing over state funds to private schools. In some American states there are targeted schemes for those on low incomes. In other states, all parents can take public money to any school they choose, whether run by the state or private entities: they have choice, and schools have an incentive to improve.

If Britons could get over their hostility to private providers and market disciplines, they might find that the voucher systems used in the Netherlands and Sweden—both bastions of social democracy—turn out to be the best way of satisfying the basic requirements of an education system. The Dutch constitution gives any school that meets legal standards the right to the same funding that a state school would get. Parents can top fees up a bit, and schools get extra money for taking the more difficult students to teach. Swedish parents can choose any school they like for their children, including for-profit and religious schools, and the local municipality will pay.

But such reforms are nowhere on the political agenda in Britain. Before the last election, the Tories flirted with a partial (and flawed) voucher scheme, which would have allowed parents to take state money into the private sector, but not to top it up themselves. Under their new leader, David Cameron, they have dropped this idea.

So, in this dismal scene, where brave ideas are instantly shot down, how do the government's reforms (set out in a white paper in October and due for debate in Parliament in February) measure up? Do they push the system in the right direction? Yes, but only just. There will be a bit more room for good schools to grow and bad ones to shrink. New providers will be helped to set up schools or take over troubled ones; successful schools will be spurred to expand and failing ones to close faster; the official bodies that used to veto such changes will be abolished. All schools will be able to apply to become “trust schools”, also billed as “independent non-fee-paying state schools”, thus gaining control over their budgets, assets, staff and admissions. Trust schools could also bring in partners such as charities, social enterprises, firms, other schools or groups of parents (see article).

Anybody there?

The proposals would be a modest advance, though they are hardly the radical departure Mr Blair claims. What's most surprising about them is their unpopularity with so many of Mr Blair's Labour colleagues (though not with the public). At least a hundred MPs oppose them. Mr Blair's former education secretary, Estelle Morris, and a past Labour leader, the hitherto loyal Lord Kinnock, are hostile. The deputy prime minister, John Prescott, is also against them, on the curious grounds that “if you set up a school and it becomes a good school, the great danger is that everyone wants to go there.” With friends like these, it is hardly surprising that Mr Blair's best chance of getting his package through is with the support of the opposition, since Mr Cameron has indicated that the

Tories will support the reforms if Mr Blair does not water them down.

Even if Mr Blair does get his reforms through, the argument over them has revealed a deeply depressing aspect of modern Britain. Passionate argument has raged over marginal changes. Genuine radicalism, of a sort that might really improve public services, is impossible. Until Britain opens its mind about how it might run itself, its schools and hospitals are doomed to be second-rate.

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On Catalonia, ticket touts, the iPod, media censorship, prices, having a grumble

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Catalonia's conundrums

SIR – Your leader on Catalonia gave a balanced description of the issues raised by the new statute of autonomy, which was approved by 120 of the 135 deputies in the Catalan parliament ("A Catalan kerfuffle", January 14th). However, you are wrong to assert that Catalonia will have a "separate judiciary", repeated in your corresponding article that the new statute "replaces Madrid's constitutional court with the regional high court as Catalonia's highest judicial authority" ("Bad echoes from the past", January 14th). These proposals are not included in the Catalan project. What the new proposal does seek is the right of the Catalan government to have full power over non-judicial staff and to have a limited say in a number of judicial appointments, but not the full power to make them. Courts and judges in Catalonia would continue to be organised and appointed according to, and continue the enforcement of, Spanish law.

This is neither a separate judiciary, nor even the federal-state judicial system that exists in Canada, Germany and the United States. Yet we think that this cautious reform improves the efficiency of the judicial system in Catalonia and elsewhere in Spain.

Josep Vallès
Minister for Justice Affairs
Catalan government
Barcelona

SIR – The blame for the current fuss over Catalonia chiefly lies with the People's Party, in opposition since 2004, for creating a political climate in which a Spanish general feels he can raise the threat of military intervention. Since it lost power, the PP has engaged in aggressive rhetoric against the government of José Luis Rodríguez Zapatero that goes far beyond the adversarial language of traditional debate. It is difficult to see where this is leading the party beyond rallying its supporters. Arithmetic suggests that if it wishes to regain power, it needs to win over the electoral centre and establish good relations with moderate nationalist parties in the regions, both of which it has manifestly failed to do.

Sebastian Balfour
Professor of contemporary Spanish studies
London School of Economics
London

SIR – If you want to see the other side of the coin of separatism in Spain you should take a look at the discriminatory policies enforced by the Catalan and Basque governments against Spanish-

speaking communities, which includes language police and the denial of an education in their mother tongue to Spanish-speaking children. This is not your run-of-the-mill David versus Goliath story, and even if it were, David is not the good guy any more.

Mark Martinez
Brussels

Paying for what you get

SIR – Re-selling tickets for sports and music events is nothing more than the free market at work ("Free-market fleecing", January 7th). Those who decry such touting as pricing the "real fans" out of seats are often the same people who claim that lower-league sports or middle-tier bands deserve more attention, yet fail to see that the two arguments are linked. As long as tickets remain at artificially low prices, fans will demand them as a right and ignore up-and-coming alternatives. This perpetuates bad economics, not to mention dreadful music and over-hyped sports clubs.

Ross Parker
London

Easy listening

SIR – There is no need to be puzzled at the iPod's success even though similar devices have "more features" ("Podtastic", January 14th). That is the point. After years of being harassed by computer gear that proliferated complex features we are now responding to the iPod's simplicity. Apple has learned from Lao Tse: "To attain knowledge, add things every day. To attain wisdom, remove things every day."

Alan Tobey
Berkeley, California

Watch it

SIR – Your article on the taming of Argentina's media, and our co-authored report that you quoted, highlights a growing threat to new democracies ("No criticisms please", January 14th). Government money and powers are being abused to buy media silence and favourable coverage around the world. These less obvious methods of interference have become popular with many post-authoritarian governments that cannot let go of old habits. The effect on press freedom is insidious, evidenced by the crooked takeovers of independent media in Russia and the use of government advertising to manipulate media content from Argentina to Botswana to Romania. As the censors become more sophisticated, so must the spotlighting of what goes on behind government-media relations.

James Goldston
Open Society Justice Initiative
New York

SIR – There were some inaccuracies and omissions regarding the Clarín Group in your article. First, contrary to your assertion that the Group's creditors "threatened to take it over", there was never any threat to assume control of the company, nor did the Clarín Group enter into any bankruptcy proceedings that would have made such a takeover possible. Thus, the law limiting foreign ownership of the Argentine media had no effect on the company's private debt restructuring.

Second, the status of the Clarín Group's cable-television licences has not changed. If you meant to refer to the ten-year extension of our broadcast licence for Channel 13, that extension was guaranteed by law and could only be revoked in case of regulatory non-compliance. Finally, the Argentine government accounts for less than 3% of the Clarín Group's total advertising revenue and our journalism is characterised by seriousness and pluralism. Your article revealed a biased approach to Clarín.

Martín Etchevers
External communications manager, Clarín Group
Buenos Aires

Consumer report

SIR – Why is it that economists seem to accept without question the idea that mass immigration would lower Japanese labour costs ("Better than people", December 24th)? The evidence from London, which is chock-a-block with migrant labour, suggests otherwise. One can travel and shop for days without encountering a single native speaker of English, yet prices (it must be the world's most expensive city) are insane.

Timothy Marrable
Tokyo

A good moan

SIR – Thoughts of grumpy Britons reminded me of A.H. Maslow's observation that although people will always gripe, the health of an organisation can be judged by the type of grumbling ("Whingeing poms", December 24th). "Low grumbles", such as serious concern over safe streets, are of a different order than "high grumbles", characteristic of raised expectations, such as disliking the response of "no problem" to an expression of thanks. Over the years I've found Maslow's observation useful in setting priorities. By the way, I am quite upset that *The Economist* reached me two days late this week.

Jack Altman
Ashland, Oregon

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America's health-care crisis

Desperate measures

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From The Economist print edition

Getty Images

The world's biggest and most expensive health-care system is beginning to fall apart. Can George Bush mend it?

GEORGE BUSH had big ideas for his second term. He promised to fix Social Security, America's public pensions system, and revamp the tax code. Despite his best efforts, Social Security reform sank last year. Rejigging the tax code has proved so politically tricky that the White House dare not push it. With almost three years to go, Mr Bush seems less a radical reformer than a struggling lame duck.

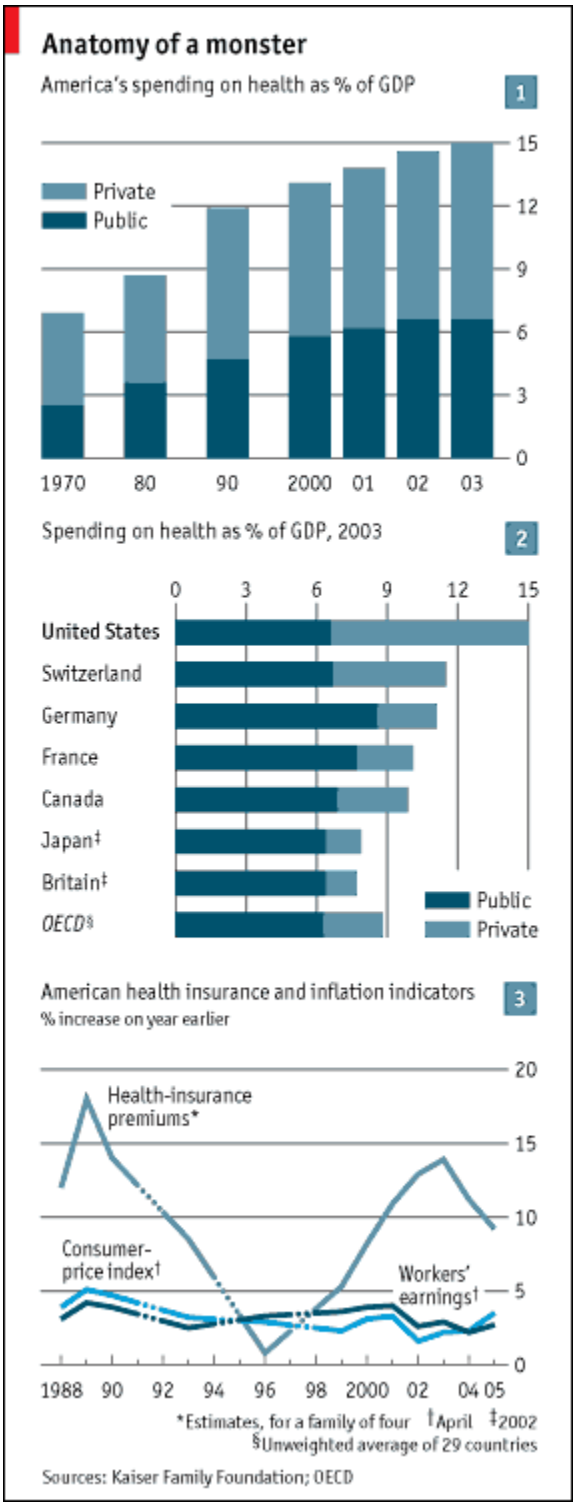
White House officials, desperate to show that the president still has a domestic agenda, have now changed the subject—to health care. The buzz in Washington, DC, is that health-care reform will loom large when Mr Bush gives his annual state-of-the-union address on January 31st. Al Hubbard, Mr Bush's top domestic policy adviser, adds that the focus will be on ideas that control costs, boost access and improve quality.

Health care? The idea seems preposterous. How can an administration that is too timid to push tax reform tackle one of the most complicated challenges facing America's economy? What's more, the timing looks terrible. Mr Bush's team is under fire for botching its biggest health-care initiative to date, the introduction of a prescription-drug benefit for elderly people covered by its Medicare programme. Thanks to bureaucratic tangles, thousands of poor old folk have been denied drugs they used to get free, and more than 20 state governments have had to step in to pay for the

medicines. Republican lawmakers dread what this fiasco may cost them in November's mid-term elections.

Yet Mr Bush may be able to push more radical change in American health care than anywhere else. Both politicians and the public recognise that spiralling health-care costs are a problem—second only to the Iraq war, according to a recent *Wall Street Journal*/NBC poll. Those costs are a big reason for the sluggish growth in workers' wages, the widespread perception that America's middle class is being squeezed and the huge job cuts at Ford this week.

America's health system is a monster. It is by far the world's most expensive: the United States spent $1.9 trillion on health in 2004, or 16% of GDP, almost twice as much as the OECD average (see charts 1 and 2). Health care in America is not nearly as rooted in the private sector as people assume (one way or another, more than half the bill ends up being paid by the state). But it is the only rich country where a large chunk of health care is paid for by tax-subsidised employer-based insurance.



This system is a legacy of the second world war, when firms, hamstrung by wage controls, used health insurance as a way to lure in workers. It means that, according to census figures, around 174m Americans get health coverage from their own, their spouse's or their parents' employer. Another 27m buy health insurance individually, for which they do not get a tax subsidy. The government picks up the tab for 40m elderly and disabled Americans (through Medicare) and about 38m poor (through the state-federal Medicaid scheme). That leaves around 46m uninsured, though many of these, whether students or workers, go without insurance by choice. In practice, they get emergency care at hospitals, which is paid for by higher premiums for everyone else.

Set alongside other rich countries, which typically offer all their citizens free (or very cheap) health care financed through taxes, America's system has some clear strengths. Consumers get plenty of choice, and innovation is impressive. One survey of doctors published in *Health Affairs* claimed that eight of the ten most important medical breakthroughs of the past 30 years originated in America. Equally clearly, the American system has big problems, notably inadequate coverage (no other rich country has armies of uninsured), spotty quality and high cost.

Huge discrepancies lurk within the system. John Wennberg, Jonathan Skinner and Elliot Fisher of Dartmouth College have pointed out that Medicare spends more than twice as much on people in Miami than in Minneapolis, and, if anything, results are better where spending is lower. Up to 30% of Medicare spending, they concluded, is wasted. Poor treatment is rife: a study by the Institute of Medicine has suggested that medical error is the country's eighth-largest cause of death.

For decades, American health-care spending has outstripped income growth, by an average of 2.5 percentage points a year. There have been clear cycles within this trend: for instance, herding employees into managed-care schemes, notably Health Maintenance Organisations (HMOs), which negotiated discounts with doctors and restricted the services available to patients, helped slow down health inflation in the mid-1990s. But voters loathed HMOs, there was a political backlash and in the late 1990s costs shot up again. Although the pace of medical spending has slowed slightly recently (to 7.9% in 2004), spending has risen by 40% since 2000. Typical insurance premiums have gone up by more than 60%.

The great unravelling

With medical inflation far outpacing inflation in general, American firms are scaling back the health coverage they offer. The share of workers who receive health insurance from their own employer has fallen from almost 70% in the late 1970s to around 50% today. In the past five years, the proportion of firms offering medical benefits has fallen from 70% to 60%, with the steepest decline among small firms and those employing the low-skilled.

Those employers who do offer health insurance have pushed more costs on to workers by raising co-payments and deductibles (the expenses before insurance kicks in). Employer-provided health coverage for retirees, once common, has shrunk, although America's big carmakers, including Ford and General Motors, are still hobbled by having to provide it. Mr Hubbard's assessment is stark: “The private market is broken.”

At the same time, the burden on government is about to soar. Add together Medicaid, Medicare and other publicly financed health care, such as that for ex-servicemen, and the public sector already pays for 45% of American health care. (The total is nearer 60% if you include the tax subsidies.) But as America's firms limit their health-care spending and, particularly, as the baby-boomers retire, that share will rise sharply. On current trends, federal spending on health will double as a share of the economy by 2020. That would mean much higher taxes, something Americans do not want to pay.

With employers limiting their exposure and government unable to fund its commitments, America's health system will unravel—perhaps not this year or next, but soon. Few health experts deny this. Nor do they disagree much on the sources of the problem. Health markets are plagued with poor information, inadequate competition and skewed incentives.

Since most bills are paid by a third party (the insurance company or the government), neither patients nor doctors face real pressure to control costs. Overall, Americans pay only $1 out of every $6 spent on their health care out of their own pockets. Doctors are generally paid for individual services and so have an incentive to perform too many procedures. The huge tax

subsidies for employer-purchased health insurance encourage expensive care. Rapacious lawyers and the risk of being sued exacerbate the tendency towards unnecessary “defensive” medicine.

The first question is whether to try to make America's imperfect market work better, or to accept that markets cannot work in health care and focus more on government regulation. The second is whether to go for incremental reform or a comprehensive overhaul.

The history of American health policy is littered with failed efforts at radical change. Harry Truman wanted to create a system of national health insurance in the 1940s. When Canada introduced its government-run health system in 1971, many American politicians hoped to do the same. The biggest recent effort was Hillary Clinton's health-care plan of 1993, which mandated health-insurance coverage for all delivered through carefully regulated health alliances with price caps. All these efforts failed, thanks to the enormous power of health-care lobbies and Americans' horror at anything that smacked of “socialised medicine”.

Today's debate is scarred by those failures, though some brave health experts still favour comprehensive reform. The Physicians Working Group, for instance, argues that America has to move to a single-payer system, as in Canada or Britain. Victor Fuchs and Ezekiel Emanuel, two prominent health experts, argued in the *New England Journal of Medicine* last year that the current mess should be replaced with a universal system of health vouchers funded by a hypothecated VAT. In a new book from the Brookings Institution called “Can We Say No?”, Henry Aaron, William Schwartz and Melissa Cox argue that America will sooner or later have to ration health care, though they are coy about exactly how.

Washington's politicians, however, have shown little appetite for radical change. Their focus is still on expanding coverage rather than controlling costs. The biggest recent policy initiative, the 2003 decision to add drug coverage to Medicare, was the biggest expansion of a government health programme since 1965.

Some states have been thinking more radically. Massachusetts, for instance, may require everyone to have minimum insurance, with the state helping poorer people with subsidies. Maryland has a new law that requires all large employers to spend at least 8% of their payroll on health care, supposedly to prevent the state's Medicaid system having to pick up the tab. Though that particular law has more to do with Wal-Mart-bashing than health care, unions are pushing for similar legislation in 30 states.

The most interesting innovations, however, have come less from think-tanks or politicians' offices than from within the health-care industry. One trend, called “Pay for Performance”, is to shift doctors' and hospitals' incentives towards providing more efficient and better care, by measuring quality and adjusting payments accordingly. According to Karen Davis, president of the Commonwealth Fund, a health-care research foundation, there are now around 100 “Pay for Performance” initiatives in place. Early evidence suggests that they are having some effect.

Patients as consumers

The second shift within the health-care industry has been to change patients' incentives with more cost-sharing and larger deductibles. If patients pay more of the upfront costs of their health care, the argument goes, they will become more discerning consumers. And some of the cost saved by employers can be put into special Health Savings Accounts (HSAs), which workers can tap to pay routine health costs. Once the account is empty, workers are responsible for paying for their health care until their deductible is reached. This should make them think twice before visiting a specialist when they get a sore throat.

The trend towards HSAs was given a big push by a tax change in 2003 that was part of the Medicare drug legislation. Provided that an individual buys health insurance with a high deductible (at least $2,100 for a family), he can put the equivalent amount of money into tax-free accounts, whose balances can accumulate over years.

The number of people with high-deductible plans is still relatively small: only 2.4m in early 2005, according to government figures. But health economists expect HSAs to grow rapidly, as ever more employers offer them to try to control costs. A new survey by consultants at Deloitte shows that in these kinds of plans, in 2004-05, costs rose by less than half as much as in traditional ones.

The Bush agenda picks up both these new trends. Without much fanfare, Medicare too has been introducing its own incentive schemes. Hospitals must now provide proofs of quality to qualify for some Medicare payments. Medicare is also experimenting with bonuses for hospitals and doctors that improve their quality and efficiency. Where Medicare leads, many others may follow.

The White House's main focus, however, is the private market. One goal is legal reform. Mr Bush has already pushed (unsuccessfully) for laws that cap payments for medical malpractice lawsuits. He will keep trying. His health advisers would also like to deregulate the health-insurance market, freeing it from the stifling rules, imposed at state level, that can raise the cost of an insurance plan by as much as 15%.

Chiefly, Mr Bush wants to accelerate the trend towards consumer-driven health care. One uncontroversial idea is to encourage doctors and hospitals to provide more information on the cost of treatment. The other is to cut taxes. Mr Bush's team wants to eliminate the bias in favour of employer-purchased, low-deductible health insurance in America's tax code, not by reducing the existing tax subsidies for employers, but by increasing the tax subsidies for individuals.

This philosophy is conveniently summarised in a new book, “Healthy, Wealthy and Wise”, by three economists with close ties to the White House, Glenn Hubbard of Columbia University (formerly Mr Bush's top economic adviser), and John Cogan and Glenn Kessler of the Hoover Institution at Stanford. They argue that since it is politically impossible to get rid of tax subsidies for employer-based health insurance, the best way to eliminate the tax bias towards high-cost insurance is to make all health spending tax-deductible and expand HSAs. Legal, insurance and tax reform together, they argue, could reduce America's health spending by $60 billion and cut the number of uninsured by between 6m and 20m. Since overall medical spending would slow, the authors reckon their suggestions would cost a modest $9 billion a year.

To an administration that believes the answer to every problem is lower taxes, the appeal of these ideas is obvious. Many health experts, however, are deeply sceptical, both about whether the shift to higher-deductible plans will actually reduce health-care inflation and, even if it does, whether the government should encourage this trend with more tax cuts.

The logic of consumer-driven health care assumes that unnecessary doctor visits and procedures lie at the heart of America's health-care inflation. And it assumes that individual patients can become discerning consumers of health care. Both are questionable. Most American health-care spending is on people with chronic diseases, such as diabetics, whose health care costs many thousands of dollars a year, easily exceeding even high deductibles.

Instead, critics worry that greater cost-consciousness will deter people, particularly poor people, from essential preventive medical care, a trend that could even raise long-term costs. A classic study by the Rand Corporation in the 1970s showed that higher cost-sharing reduced both necessary and unnecessary medical spending in about equal proportion.

Nor is it obvious that people actually behave like discerning consumers in health care, even when they have information. Proximity of hospitals and word-of-mouth reputation often matter more to patients than published quality indicators. Sceptics of consumer-directed care like to point to Bill Clinton, who chose to have his heart surgery in a hospital that New York state rates as having merely average mortality rates for such operations.

The truth is that the shift to consumer-directed health care and greater cost-sharing involves a culture change that may take decades. It will also come at the price of greater inequality. The burden of health spending will be shifted on to those who are sick, and not just because people will pay a greater share of their health costs themselves. High-deductible insurance policies are attractive to the young and healthy. But as these workers leave traditional insurance, the risk pool in other insurance plans will worsen and premiums will rise even faster. The real losers will be poorer workers with chronic illnesses.

American health care has already become more unequal as employers have cut back, and this will continue. The Bush team argue that “fairer” tax treatment will slow cost rises and enable more people to get basic insurance. The opposite is more likely. Bigger tax subsidies for health care are, if anything, likely to raise overall spending. Worse, since most tax breaks benefit richer people most, more tax incentives are likely to bring more inequality. They will also reduce tax revenue and worsen the budget mess.

Mr Bush's health-care philosophy has a certain political appeal. It suggests incremental change rather than a comprehensive solution. It reinforces existing industry trends. And it promises to be pain-free. Unfortunately, it will not work. The Bush agenda may speed the reform of American health care, but only by hastening the day the current system falls apart.

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Pork and scandals

Hobbling the lobbyists

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From The Economist print edition

Congress wants to impose restrictions on lobbyists. Fair enough, but it is Congress itself that most needs curbing

THE juiciest gossip in Washington this week concerns photographs of George Bush shaking hands with Jack Abramoff, a crooked lobbyist. So far, only a few people have seen them, but it cannot be long before they are leaked, published and festooned with amusing captions.

Mr Abramoff, whose clients gave money to at least 195 Republicans and 88 Democrats, pleaded guilty to fraud earlier this month. Since then, the Democrats have attacked the Republican "culture of corruption", their case bolstered by the admission of Congressman Randy "Duke" Cunningham that he accepted bribes from defence contractors. And Mr Abramoff is expected to tarnish more reputations in the hope of reducing his sentence.

White House officials admit that Mr Bush has met Mr Abramoff, but deny that the two knew each other well. The president has his picture taken with thousands of people. All you have to do to join a presidential meet-and-greet line is donate a stack of money to the Republican Party. For lobbyists, such donations are a good investment, since the resulting photo may convince gullible clients (a niche market in which Mr Abramoff specialised) that you wield more influence than you do.

Inevitably, both parties are calling for a clean-up. Nancy Pelosi, the Democratic leader in the House of Representatives, vowed last week "to turn the most closed, corrupt Congress in history into the most open and honest Congress in history". Her party's proposals include banning all gifts from lobbyists to politicians, including free "fact-finding" trips to golf courses, and toughening

public disclosure of lobbying activity. The Republican Speaker, Dennis Hastert, suggested a similar package of lobbyist-bashing reforms, equally sensible but equally beside the point.

Lobbying can't be banned—Americans have a constitutional right to “petition the government for a redress of grievances”. And they have an awful lot of grievances. For instance, Ted Townsend, a meat-packing tycoon, is aggrieved that his home state of Iowa has no indoor rainforest. He's been pitching the idea for several years: it would be “the coolest new attraction on Earth”, not to mention a “goose that will lay enormous golden eggs” for Iowa.

In 2003, Mr Townsend gave $3,000 in campaign contributions to his Republican senator, Chuck Grassley. The next year Mr Grassley secured $50m from the federal budget for Mr Townsend's rainforest. There was absolutely nothing illegal about this. Mr Grassley was entitled to accept Mr Townsend's cash, and he no doubt sincerely believes that an indoor rainforest will benefit Iowa.

This story illustrates why influence-peddling is such a problem. Individual lawmakers have immense power to take money out of the public purse for the narrowest of purposes. Any one of them can slip an extra paragraph into a bill to secure funding for a project that may have nothing to do with the bill's stated purpose. Such “earmarks” are often inserted at the last moment and pass without scrutiny.

Projects funded this way are typically those that make sense on someone else's dime. (Iowans, weirdly, have been somewhat reluctant to chip in more than peanuts to their rainforest, prompting Senator Grassley to say he may cut back the federal contribution.) Earmarks are also an open invitation to corruption, since you only have to incentivise one congressman to win a fat slice of federal cash, and there are lots of legal ways to do it.

So long as the contribution conforms with campaign-finance laws and no legislative favour is explicitly traded, you are probably in the clear. And the congressman who takes your money will not consider himself corrupt, because he is not trying to enrich himself. With a few exceptions, such as Duke Cunningham, congressmen solicit money to get re-elected, not to lounge on yachts. From an ordinary citizen's perspective, however, it is not clear how this is better.

Lobbyists are not the disease, merely the symptom. Their numbers (in Washington) have doubled in the past five years, to 35,000, because federal spending has grown larger and more wasteful. Earmarks have proliferated under the Republicans, from 1,439 in 1995 to 13,997 last year. Politicians of both parties love them, because they allow an individual lawmaker to take credit for delivering a specific goody to his constituents.

The worst offenders are usually the most senior members of Congress. Because they sit on powerful committees, they have more power to shower interest groups with taxpayers' money. Those interest groups reward them with campaign donations. After a while, incumbents become so good at raising money that they are impossible to dislodge. In his last race, Senator Grassley spent 47 times more than his challenger and beat him by 42 percentage points.

When it comes to regulations, lobbyists push in many different directions, but when it comes to spending, they almost all push the same way. The lobby for spending less is “tiny to non-existent”, says John Samples of the libertarian Cato Institute.

Lawmakers face perverse incentives. Voters reward them for bringing home the bacon, not for standing back while their colleagues scoff the lot. So, at a time of looming fiscal meltdown, politicians brag about their profligacy. Robert Byrd, the ranking Democrat on the Senate Appropriations Committee, whose name is carved on to $1 billion-worth of highways and office complexes in West Virginia, says he enjoys being called the “King of Pork”.

And the deficit grew

Ms Pelosi, who secured $115m this year for transport, housing, science and the arts in her needy native San Francisco, proposes an end to “dead-of-night special-interest provisions that turn bills into special-interest giveaways”. In other words, she'd like to make earmarks more transparent, but not get rid of them.

Among Republicans, the most interesting debate is between the three candidates to succeed Tom DeLay, the legally troubled House leader (see article). Roy Blunt, John Boehner and John Shadegg all agree with Ms Pelosi that earmarks should be more transparent. Critics charge, however, that Mr Blunt and Mr Boehner are too cosy with lobbyists to make plausible champions of reform. Small-government enthusiasts tend to back Mr Shadegg, who wants to force Congress to spend less and abide by its own budgets.

Restrictions on lobbying would be good, as can be deduced from the fact that the lobbying industry is already lobbying against them. And greater scrutiny of earmarks would doubtless weed out a few cowgirl museums and tattoo-removal programmes. But there is a larger challenge.

The government's estimated liabilities (including future obligations under Medicare, Medicaid and Social Security) jumped from $20 trillion in 2000 to $43 trillion in 2004, according to the Government Accountability Office. That implies a fiscal catastrophe that Congress doesn't seem serious about averting, perhaps because that would mean placing restrictions on itself, not just on lobbyists.

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Tom DeLay

Hotly pursued

Jan 26th 2006 | HOUSTON
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A not-so-safe seat in Texas

THE contrast could not be sharper. Tom DeLay's spacious campaign headquarters sits in a perfectly manicured subdivision of suburbia, just down the street from the local golf club. His Democratic opponent, Nick Lampson, can muster only a cramped two-room office in a nondescript shopping centre a few blocks away from NASA's sprawling space centre.

AP

Nick the Hammer-snapper

In 2004, Mr DeLay, then the House majority leader, coasted home with 55% of the vote. But this year's battle looks a nail-biter. Mr DeLay is mired in ethical swamps in both Austin, where he faces charges of campaign-finance wrongdoing, and Washington, DC, where his associates are embroiled in the Abramoff scandal. A recent poll by the *Houston Chronicle* gives him a woeful 28% approval rating in his own district. If the election were held today, just 22% of registered voters would cast their ballot for the Hammer against 30% for Mr Lampson, according to the poll.

Chris Homan, Mr DeLay's campaign manager, seems unperturbed. “Our internal numbers show strong enough support to be winning,” he says. Mr DeLay, who also faces the indignity of a primary challenge, is much better known than any of his opponents. Come November, he will turn out the Republican faithful, who are often straight-ticket voters (ie, they vote the party line on every candidate).

Many of the old guard do indeed seem be happy to go along. “Tom will get my vote again, absolutely, unless they put him in jail,” says one elderly mall-goer. But as the *Chronicle* poll implies, for most locals it is a case of wait-and-see. “I'm reconsidering my support, but I haven't decided yet,” says Jamie Clouse, a computer specialist who voted for Mr DeLay in 2004.

Alas for Mr DeLay, there is no guarantee of better news in either Austin or Washington. Mr Homan calls the prosecutor in the Austin case “a political tool for the Democrat Party”—but a trial could mar the campaign season. And Mr DeLay's ties to Jack Abramoff, the disgraced former superlobbyist, will be much investigated this year. At least two of his former aides figure in that money-for-influence scandal, and Mr DeLay's own golf trips and general chumminess with Mr Abramoff have become political liabilities, though he has not been implicated. “The best Mr DeLay can hope out of Washington is continuing bad publicity but he's not indicted,” says Richard Murray, a political-science professor at the University of Houston.

Such troubles were unimaginable when Mr DeLay organised Texas's controversial redistricting four

years ago (which ended up with the state losing six Democrats, including Mr Lampson). Ironically, Mr DeLay did not use that process to make his own seat safer: the change actually pushed a few more Democrats into his own district. In fact, about one-fifth of Mr DeLay's district is actually Mr Lampson's old one.

Mr Lampson, the toughest candidate Mr DeLay has faced for some time, insists he is not trying to make ethics the heart of his campaign; he vows instead to emphasise homeland security, fiscal responsibility, education and access to health care. Both men will be raising money madly, from all over the country. Mr Lampson is already sitting on more than $1m in cash, which is a tidy pile for a challenger at this early stage.

Another problem for Mr DeLay, assuming that he survives the primary, is Steve Stockman, a former Republican congressman who has entered the race as an independent. Mr Stockman will need 500 votes to get on the ballot in November. He has vowed to go after Mr Lampson, but since his politics are to the right of Mr DeLay's, he may end up pulling support away from him. (According to the *Chronicle* poll, he could draw 11% of election-day voters.) That prospect is not good news for the Hammer on his home turf.

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Another nuclear revolution

Rethinking the unthinkable

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A scary thought to consider: more reliable nuclear weapons

BACK in the days before Iraq, George Bush's nuclear ambitions marked him out to his critics in Congress as a wild-eyed cowboy. He was the man who scrapped the once-hallowed anti-ballistic missile (ABM) treaty with Russia, started exploring new missile defences, opposed ratification of a comprehensive test-ban treaty and began looking for ways to develop new nuclear "bunker-buster" bombs.

Nowadays, however, some of Mr Bush's ideas look normal and unscary. The ABM treaty, for example, is now unlamented everywhere. Mr Bush has persuaded Russia to agree that by 2012 the two countries will have no more than 1,700-2,200 deployed strategic warheads each (down from America's 4,500 or so today, though the figure could rise thereafter). He has also cut the numbers of extra warheads to be held in reserve for spare parts or for a rainy (and dangerous) day.

That has recently allowed America to release some 200 tons of highly enriched uranium (enough for more than 8,000 weapons) for more peaceful purposes. Most of it will go into powering naval ships, but HEU is also being used in space and research reactors, as well as being blended down for use in civilian reactors.

Congress is still pressing Mr Bush to clean up nukes in the old Soviet Union (see article). But the real arguments are over what to do about America's own weapons.

For two years running, Congress has rejected the Department of Energy's request for money to research the bunker-busters. The department has now abandoned the idea, though with regret. Officials whinge that they just wanted to see if a warhead casing which the Clinton administration tested for its ability to penetrate ice could be made to penetrate a little way into rock.

The argument is complex. The administration still thinks that bunker-busters would deter proliferators, by making it harder to hide nuclear, chemical or biological weapons. Congress worries that any weapon that can penetrate rock will throw up lots of radioactive fallout. Meanwhile, even just researching such weapons has made it harder for the administration to argue that North Korea and Iran should halt any weapons-tinkering.

David Hobson, chairman of the mild-sounding House energy and water appropriations subcommittee, has led the attack on the bunker-buster. (His problem with it, he once said, is that "some idiot might try to use it.") Instead, he helped vote some $25m for a different project: the reliable replacement warhead (RRW).

The idea is to redesign new parts for America's ageing stockpile that would make the warheads more reliable, longer-lived and safer to maintain. This sounds like prudent housekeeping; in fact,

it could have a much more radical effect than the bunker-buster, whose use was limited.

During the cold war, the trick was to get the biggest possible bang into smallish warheads that could be clustered on a missile. That meant pushing the designs and materials used to build the bombs to their limits. As such weapons age, the worry is that they may deteriorate faster. Checking them requires tricky and costly maintenance. Now the idea is to try using different, less toxic materials and to put in extra safety and security features to make sure the warheads work and last longer. Ideally, you might not even have to test them.

Already two of America's weapons labs are busy on designs. But RRWs open up plenty of possibilities. Some of them are good. For instance, if warheads are more reliable, safer and easier to maintain, America could get rid of even more of those it holds in reserve in case some weapons develop flaws, and cut back its spending on the infrastructure for maintaining the stockpile. But more difficult questions arise. How can anyone be sure the things will go bang when needed if they can't be tested? And how far can technicians go in redesigning parts for existing warheads before they end up building what are, in effect, new ones?

It is not as if the RRW kills the bunker-buster. If new warheads are to be built, why not build them with new missions in mind too, like hitting an opponent's buried command-post or weapons cache? It is a thought that will keep many of Mr Bush's critics up at night.

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The nuclear clean-up

Locking things down

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The world is being made safer—but not quickly enough

EVER since the September 11th attacks, the Bush administration has piled money into the effort to prevent nuclear weapons, materials and skills from falling into terrorist hands. It now spends $1 billion a year on the nuclear clean-up in the former Soviet Union—a sum which allies from the G8 group of richer countries have pledged to match.

But is it enough? Even before September 11th a bipartisan commission set up by the Department of Energy (DOE) recommended that it was worth finding $30 billion over eight to ten years to complete the clean-up faster. It was ignored. In its most recent report, the September 11th commission agrees: “The size of the problem still dwarfs the policy response.” Congress has intervened to stop the Pentagon diverting money to other causes, most recently Iraq.

Officials at the DOE say the main obstacle is not a lack of American cash but Russian foot-dragging. A dispute about liability which held up plans for America and Russia each to dispose of 34 tons of excess weapons plutonium only ended last year after George Bush and Vladimir Putin bashed officials' heads together. Two Russian reactors still making plutonium will at last be shut down by late 2008, and a third by 2010.

In general, Russia's armed forces have been co-operative. Security upgrades at naval sites should be finished by the end of this year. The strategic rocket forces, which control nuclear warheads, have listed more of their sites, and security should be reinforced at these by 2008. The difficulty comes with Russia's civilian sites. Four-fifths of these sites, containing about half the country's highly enriched uranium (HEU) and plutonium stocks, have had security upgrades, but Russia's Atomic Energy Agency is blocking access to four large sites.

Another risk comes from the research reactors that the old Soviet Union (like America) supplied to its friends—and which are now packed with HEU. The Americans have helped recover unused uranium fuel from Kazakhstan, Georgia, Serbia, Romania, Bulgaria, Libya, Uzbekistan, the Czech Republic and Latvia. That still leaves more than 100 research reactors in 40 countries with more than 20kg of HEU. These might eventually be converted to run on lower enriched uranium, as has happened in the Czech Republic. There are plans afoot to recover spent fuel from other countries, too.

Once again, the problem may not be money. Laura Holgate of the Nuclear Threat Initiative (NTI), an organisation involved in the clean-up, thinks the process could be speeded up if commercial contractors were allowed to handle some of the less tricky cases. NTI has been helping Kazakhstan blend down around 3,000kg of its HEU for use in civilian reactors. Kazakhstan could perhaps do this job for others, too.

Maria Cantwell

No refuge

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From The Economist print edition

A gutsy dotcom lady with a tough fight on her hands

JUST before Christmas, one of the Senate's most feared members, Ted Stevens, an 82-year-old Republican from Alaska, slyly inserted into a $453 billion defence bill permission for oil-drilling to go ahead in the Arctic National Wildlife Refuge (ANWR). The ruse was that Democrats would not want to appear to be soft on defence; but they rallied to remove the ANWR wording from the defence bill in a 48-45 vote.

Mr Stevens's most vigorous foe was a relatively unknown young senator from Washington state. Maria Cantwell, a former high-tech manager, buttonholed colleagues to block drilling, even donning a similar “Incredible Hulk” tie to the one Mr Stevens wears when he goes into battle.

Ms Cantwell's greenery has gone down well in her home state—especially the populous western half where most of the Democrats are gathered. When she sneaked into office in 2000, beating the incumbent, Slade Gorton, by a whisker, she was helped greatly by two things: the local Republicans had jumped to the right on issues like abortion, and her millions in stock options from her time at RealNetworks, an internet firm, allowed her to outspend her opponent by $11.5m to $6.4m.

Six years later, and up for election again, Ms Cantwell is no longer so rich. Her wealth evaporated in the dotcom bust, so she has to raise cash just like everybody else. The Republicans are also in better shape. Angry that all three of the state's main political prizes—its two Senate seats and the governor's mansion—are all in Democratic hands, they have taken measures to improve themselves.

Chris Vance, the party's combative state chairman, is working hard to depict Ms Cantwell as an “obstructionist”. He also berates her for eschewing outside campaign donations during her 2000 campaign, then quickly accepting them once in office. It does not help that she received $17,865 from organisations linked to Jack Abramoff, the disgraced lobbyist. She is now giving it to charity.

Above all, Mr Vance says his party has a strong candidate in Mike McGavick. A former insurance-company executive, Mr McGavick is smooth, telegenic and takes a moderate stance on social issues. He also has plenty of cash, not least from the oil companies which Ms Cantwell has offended. But he has never run for political office before.

Lance LeLoup, a professor of political science at Washington State University, thinks the party would have done better to have chosen Dino Rossi, who lost the 2004 governor's race after two recounts and a lawsuit and came out of it with much sympathy from voters. But Mr Rossi demurred, opening the door for Mr McGavick.

Mr McGavick's inexperience gives Ms Cantwell the edge. But expect a long, nasty fight. If the

senator were ousted, Democratic hopes of regaining the Senate would disappear. Meanwhile, a McGavick victory would open up options for the Republicans in 2008. If the Pacific north-west were pushed back “into play”, that would give the party more room for error in the crucial swing states of the mid-west.

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University life

On red alert

Jan 26th 2006 | LOS ANGELES
From The Economist print edition

How to prevent the warping of impressionable minds

FANCY being a student mercenary in the culture wars? Go to the University of California's giant Los Angeles campus and take notes—or, better still, tape recordings—of any professor who "just can't stop talking about President Bush, about Howard Dean, about the war in Iraq. If you can help UCLAProfs.com collect information about abusive, one-sided, or off-topic classroom behaviour, we'll pay you for your work."

This offer—rates as high as $100 with a tape recorder supplied—was made earlier this month by Andrew Jones, a 24-year-old UCLA graduate who once headed the campus's student Republicans and who believes that far too many of UCLA's 3,300 teaching staff are left-wing radicals intent on warping the impressionable minds of their 35,600 students. This week, amid howls of protest from the university, Mr Jones abruptly withdrew the cash incentive, saying he wanted to protect his spies from possible legal action. But he still wants ammunition on Bolshie teachers, and his website, which names some 31 professors who deserve special scrutiny, accuses one of raging about "a Bush Reich" and others of being anti-Israel.

The professors point out that UCLA already lets its students give anonymous evaluations of their teachers. They say Mr Jones, the sole employee and founder of his Bruin Alumni Association, is the real zealot.

The cash-for-tapes ploy may be unsubtle, but it reflects the keenness on the right to tackle what many see as the American left's last redoubt. Mr Jones persuaded a score of well-known local conservatives to serve on his advisory group (though at least three have now resigned). Others on the right want state legislatures to pass "an academic bill of rights" forcing universities to have more politically diverse faculties. Given conservatives' success in changing Congress, the judiciary and the press, pinkish academics have every reason to be scared.

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Lexington

The papal court

Jan 26th 2006
From The Economist print edition

The Supreme Court goes over to Rome

AND then there were five. Samuel Alito will not glide on to the Supreme Court as gracefully as John Roberts. But glide he will. The Democrats don't have enough votes to block him in the full Senate (they have already lost a party-line vote in the Judiciary Committee). And they don't have the political capital to mount a filibuster. The result: the Supreme Court will soon have a Catholic majority for the first time in American history.

This is a remarkable historical turnaround. Arthur Schlesinger senior once remarked that prejudice against the Catholic church was “the deepest bias in the history of the American people”. The Protestant majority denounced Catholics as minions of the anti-Christ and servants of a foreign power, marginalised Catholic schools, demonised Catholic pastimes, particularly drinking, and tried to keep them out of high political offices. It is not so long since presidents observed an unwritten convention against having more than one papist on the court.

The turnaround is all the more surprising for two reasons—who was responsible and when it happened. The Catholic takeover of the court has been engineered by the Republicans—the erstwhile party of the Protestant hegemony. And the takeover has coincided with the worst scandal in the Catholic church's history in America: a paedophilia crisis involving dozens of abusive priests and cover-ups by the Catholic hierarchy.

So why have the Republicans been so keen to tap Catholics? The most obvious reason is political:

the Catholic vote is up for grabs. Catholics were once a solid Democratic constituency, up there with blacks and Jews. They began to turn against the Democrats in the 1970s when the latter moved to the left on issues such as abortion. Ronald Reagan won the Catholic vote easily in 1984 (Catholics were the archetypal Reagan Democrats). But they are not reliable Republicans. Bill Clinton won a plurality of the Catholic vote in 1992 (41%) and a majority in 1996 (53%). Catholics voted for Al Gore in 2000 (50% to 47%) but then George Bush in 2004 (52% to 47%).

One of the perks of being swing voters is that politicians have to work hard to woo you. The Republicans recruited 50,000 Catholic “team leaders” in 2004 and Mr Bush even put up with an earwigging from John Paul II over Iraq so that he could get his picture taken with him (the picture appeared on his website over the slogan “Catholics for Bush”). And what better way of wooing Catholics than nominating their intellectuals to the Supreme Court? This not only delights Catholics. It also embarrasses Democrats, who face a choice between annoying left-wing interest groups or insulting Catholic voters.

There is more than just vote-counting at work here, however. Conservative Catholics have formed a close alliance with one of the Republican Party's most powerful constituencies—Protestant evangelicals. Evangelicals were the very heart of Protestant anti-Catholicism. But the two groups united in fury at the Supreme Court's decision to make abortion a constitutional right in *Roe v Wade* (1973); and they have now broadened their alliance on issues from school choice to family values.

The Catholics bring two things to this alliance. The first is intellectual firepower. Mark Noll, a leading evangelical scholar, has even written an eloquent book lamenting that “the scandal of the evangelical mind is that there is not much of an evangelical mind”. There is more than enough Catholic mind to make up for it. The Catholic church has a rich record of legal scholarship, particularly in the natural-law tradition; and Catholic high schools have a proud history of sending their brightest sparks to law schools.

The second is respectability. You can't get away with anti-Catholic rants as easily as you can with anti-evangelical bigotry. This is partly because Catholics are a much more diverse group: they include pro-choice moderates such as Rudy Giuliani and Arnold Schwarzenegger as well as hard-liners. Catholics can also display the wounds of past discrimination. And they don't have the same southern stigma. Mr Alito just about got away with mentioning his disapproval of his fellow Princetonians—rich radicals behaving badly—at his confirmation hearing. Had he been a southern evangelical, he would have been labelled an intolerant Puritan keen to bring back Prohibition.

Just like everybody else

Above all, Catholics are becoming ever more mainstream. The Catholic electorate is probably not that different from the population as a whole, even on issues such as abortion and euthanasia. Millions of traditional Catholics manage to ignore the “crazy aunt of Catholic dogma” on matters such as birth control. The court's Catholic majority is unlikely to vote as a block, even though they were all appointed by Republican presidents. Antonin Scalia (Reagan 1986) opposes the legalisation of sodomy, but Anthony Kennedy (Reagan 1988) supports it. As for following Rome, Mr Kennedy has upheld *Roe* and Mr Scalia has blasted the papal line on the death penalty. Clarence Thomas, who has returned to Rome since being appointed to the court, has generally stuck to the Scalia line on matters Catholic.

Mr Alito's arrival on the court may be more of a swansong for Catholic America than the beginning of sustained popish hegemony. The America that produced so many Catholic intellectuals—the parallel America of Catholic schools and Catholic youth organisations—has dissolved as Catholics have moved out of their urban ghettos and into the anonymous suburbs. The Catholic faith is

becoming ever less distinctive as conservative Catholics slide into the pews with conservative evangelicals, and liberal Catholics swap ideas with liberal Protestants. Three of Mr Alito's most bitter critics in the Senate were fellow Catholics—Edward Kennedy, Patrick Leahy and Richard Durbin. Which is surely a triumph for the American way.

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Canada's election

Stepping cautiously to the right

Jan 26th 2006 | OTTAWA
From The Economist print edition

The Conservatives, led by Stephen Harper (below), ended 12 years of Liberal rule, but Canada will have its second consecutive minority government

Reuters

“A CHANGE of government, not a change of country,” was how Stephen Harper, the Conservative leader, described his party's victory to some 2,000 cheering supporters in his Calgary riding (constituency) in the early hours of January 24th. As he had throughout a seven-week campaign, he was at pains to deny his opponents' portrayal of him as a far-right clone of George Bush. Yet in some ways he sold his achievement short. True, a Liberal minority government will be replaced by a Conservative one with even fewer seats—just 124 of the 308 in the House of Commons. But Mr Harper's clever campaign has taken his party back to power after a dozen fractious years in the wilderness. Its arrival in government signals incremental policy change and—perhaps more importantly—shifts in Canada's political geography.

The Conservatives broke the Liberal stranglehold on Ontario, winning 40 of the 106 seats in Canada's most populous province. And they even picked up ten seats in French-speaking Quebec, their best result there since 1988. Mr Harper's victory also signalled the emergence of a third centre of political power—in western Canada, whose resource-based economy is booming. His political roots lie in the small-government social conservatism of the Alberta-based Reform Party.

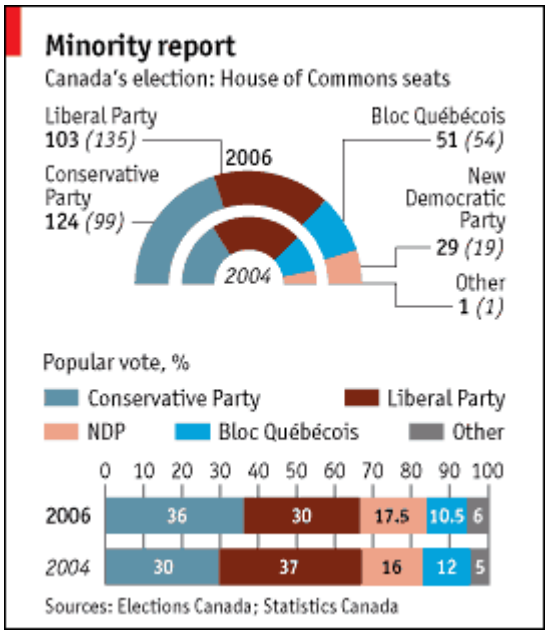
In 2003 he merged its successor with the eastern-based, “Red Tory” Progressive Conservatives. Having long felt marginalised in federal politics, “the West is now in”, Mr Harper proclaimed in triumph in Calgary. The big cities, however, are out. The Conservatives failed to win a single seat in Toronto, Montreal or Vancouver.

The election produced some surprises. Paul Martin, the outgoing prime minister, ran an ill-starred campaign, but his dogged efforts prevented the Liberal debacle that many had predicted. The

leftish New Democrats (NDP) did well, picking up seats in Ontario and British Columbia. But Jack Layton, the NDP leader, will not hold the balance of power as he did in the outgoing parliament.

In another surprise, the separatist Bloc Québécois fared relatively poorly. Its share of the vote in Quebec fell to 42%, down seven points from the 2004 election and well short of the majority that its leader, Gilles Duceppe, had sought. That was mainly because of the Conservative revival in the province. This cheered federalists by giving Quebeckers the option—which they have recently lacked—of being able to vote against the government without backing the separatists.

A last-minute recovery in Liberal support may have deprived Mr Harper of 20-30 extra seats. That has made the task of governing harder. But he has scope to strike deals, issue by issue. He will focus on five main policy pledges. These include cutting the sales (ie, value-added) tax, initially by one point to 6% and later to 5%, and giving all parents of under-fives C$1,200 ($1,025) a year for childcare. Both these giveaways are popular. Mr Harper insists he will stick to the Liberals' policy of balanced budgets and low inflation. Such is the strength of the economy that he can probably meet both sets of promises.



Two other proposals are fairly uncontroversial: tougher sentences for gun crimes; and a law to clean up government after a small-scale corruption scandal. His proposal to allow patients to seek private treatment if the public Medicare system is too slow will face greater opposition.

Mr Harper learnt from the 2004 election when Mr Martin scared voters off by painting him as an extremist. This time the Conservatives adopted a moderate face. At least while he is in a minority, Mr Harper is unlikely to place much emphasis on moral issues. He has promised a free vote on whether to repeal gay marriage legislation, but is unlikely to touch the abortion law. In foreign policy, he will offer warmer relations with Mr Bush, but has otherwise been vague.

His hope will be that after 18 months, he can go to the country again to secure a majority. That is what another Conservative leader from the west, John Diefenbaker, managed in 1958. If he succeeds, Canadian politics may then move more sharply to the right.

Two things will help Mr Harper. After two elections in less than two years, Canadians are unlikely to welcome another soon. So the opposition parties will be reluctant to bring the government down.

Second, the Liberals will be preoccupied with their own problems. Despite their successful economic management, they were punished by voters because they were seen as having grown too comfortable with the perquisites of office. Mr Martin, an effective finance minister, was a disappointing prime minister.

The Liberals will hope a spell in opposition will allow them to repair a fatal feud between Mr Martin's supporters and those of his predecessor, Jean Chrétien. In a dignified speech after a campaign that was unusually dirty by Canadian standards, Mr Martin announced on election night that he would step down as leader.

One contender for the job is Frank McKenna, a former premier of New Brunswick who resigned on January 25th as Canada's ambassador in Washington, DC. Another may be Michael Ignatieff, a writer and academic who was successfully parachuted into a Toronto seat after three decades teaching in Britain and at Harvard.

After 12 years in opposition, the Conservative parliamentary caucus contains few MPs with experience of government. It is long on social conservatives and short of women. Yet its leader has already shown himself to be a far more formidable politician than his detractors thought.

Canada will not become a different country overnight, as Mr Harper stressed. But he has engineered a crack in the big-government, socially liberal and politically correct consensus that marked the Liberal years. Two months ago, few expected that. In the months ahead, whatever else happens, Canadian politics is unlikely to be dull.

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Mexico

Halfway back

Jan 26th 2006 | CANCÚN
From The Economist print edition

Repairing Cancún after Wilma

THREE months after Hurricane Wilma hovered over Cancún for two days to devastating effect, Mexico's largest tourist resort is halfway back to life. The city itself looks normal, with utilities restored and almost all its businesses open again. But the all-important “hotel zone” on the sandbar to the east is, in the words of one hotelier, “ground zero—cranes, dust and construction all over.”

A building site all to themselves

According to Javier Aranda, a local tourism official, roughly 11,000 of Cancún's 27,500 hotel rooms are now open. But most of those are in cheaper properties in the city. The “hotel zone”, where the smarter all-inclusive resorts are located, took the full force of sea and storm. There, up to 90% of rooms are still closed. Only one discotheque is open. Many restaurants and shopping plazas are shut for lack of customers. Business at those that are open is at 30% of normal levels.

On the nearby island of Cozumel, all three of the piers at what was once one of the world's busiest cruise ship ports were wrecked. The first of them will be fixed by September, but the third not until May 2007. Cruise ships are calling at Cozumel again, but disembarking passengers by tender, so fewer go ashore.

On top of the $2 billion capital cost of repairs, Mr Aranda estimates that Wilma is costing the area $150m a month in lost tourism revenue. Surprisingly few of the 300,000 or so with jobs in tourism are out of work. Some workers at big chains have been sent to hotels elsewhere; others have taken building jobs.

Rebuilding, now feverishly under way, was slow to start, mainly because of delays in insurance payouts. Only 30% of the money owed to local businesses has been paid, says Kit Bing Wong of the restaurateurs' association.

Many hotels are taking the opportunity to renovate. Mexico's government is paying $20m for a dredge to bring offshore sand to replenish Cancún's beaches, which were washed away. They should be restored by the end of April. Locals would like to double the size of the pre-Wilma beach, which would take several months more.

South of Cancún, hotels on the “Mayan Riviera” were spared by the storm, and are 80% full. But Cancún itself has missed out on its winter high season. Sergio Serra, of the Cancún Hilton, says that many guests are regulars, and will soon be back. Most hotels should be open again by early

summer—just in time for the next hurricane season.

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Venezuela's prisons

Reform or riot

Jan 26th 2006 | CARACAS
From The Economist print edition

Efforts to humanise a hellhole

LA PLANTA prison is a squat, concrete block, set beside a motorway interchange in a district of Caracas that, ironically, is called El Paraíso (Paradise). There is nothing heavenly about the jail's bare passageways and overflowing sewage pipes. Decades of neglect are everywhere apparent, right down to the peeling walls and the vase of dead roses in the governor's office. But mingling with the smells of raw sewage and disinfectant is that of fresh paint. The government of Hugo Chávez, who himself spent two years in jail after a failed coup in 1992, has begun a plan to "humanise" Venezuela's penitentiaries.

Prisons in many Latin American countries are hellish. At least six people died in a prison riot in Rondônia state in Brazil on January 24th. In October, 33 inmates were killed in an Argentine jail.

Venezuela's jails, say prison-reform groups, have long been among the worst. On an average day, at least one prisoner dies violently, the result of overcrowding, the availability of drugs and guns, and a poorly trained and understaffed prison service. "If you don't have a *chuzo* (a handmade knife), you can't survive in prison," said Jesús Adirio Quiroz, an inmate.

Mr Quiroz has spent 18 months in La Planta awaiting trial for car theft. Nearly half of Venezuela's 19,000 prisoners have not been convicted. They mingle with hardened convicts. A fading sign over the gate describes La Planta as a centre of "observation and classification". But no classification has been done for years, says Xavier Henríquez, the governor. Over 1,130 prisoners occupy a jail built for 500.

The prisons, admits the interior minister, Jesse Chacón, "are warehouses for people". Since Mr Chávez took office in 1999, eight interior ministers and 12 prisons' directors have failed to stop the system from getting worse. That is now set to change, according to the "humanisation" team set up by Lieut-Colonel Erling Rojas, an army officer who is the new prisons director.

Helped by hundreds of volunteers and several dozen Cuban advisers, the team spent six weeks interviewing prisoners. Under a "prisons emergency" decreed in late 2004, it has obtained money for repairs. Sports, education and cultural activities have resumed. Mr Chávez's "missions"—emergency schooling and health programmes—are venturing inside the prison walls. La Planta was recently declared Venezuela's first "illiteracy-free" jail.

There is a long way to go, and little guarantee that a government noted for improvisation and a short attention span will stay the course. Lieut-Colonel Rojas, whose past achievements include sorting out the customs and a state television channel, took the job on condition he could have it for at least a year.

Humberto Prado, an ex-prisoner and now a lawyer who runs the Prisons Observatory, an NGO, is

sceptical. “There's no interest in fixing the problem—that would ruin their business,” he says, referring to the mafias that even the authorities admit control the flow of guns, drugs and other contraband in the jails.

Much will depend on the new policy of talking to the inmates. “Before, they used to kill two or three of their number just to get people's attention,” says a member of the humanisation team. “Now we bring them in and have them fire questions at the directors.” If questions were all they fired, that would be progress.

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Bolivia's new president

Evo ready or not

Jan 26th 2006 | SÃO PAULO
From The Economist print edition

Radical cabinet, ambiguous message

Get article background

AFP

Nothing to lose but his chains

EVO MORALES, who took office on January 22nd as Bolivia's first elected president of indigenous descent, is still trying to be all things to all men. In a long and rambling inauguration speech, he saluted Che Guevara, denounced “neo-liberalism” and coca eradication, called for the nationalisation of natural resources and the setting up of state-owned industries, and thanked Venezuela's Hugo Chávez for his support. He also called for private investment, for an “alliance” against the drug trade with the United States, and hinted that he might support an Americas free-trade accord if it helped small business.

His first actions smacked more of radicalism than pragmatism. The cabinet he has formed consists mainly of activists from the social movements that vaulted him to power and their intellectual allies. Nearly all have as little experience of government as Mr Morales, who led a coca growers' union. Carlos Villegas, the new development minister, opposed an IMF-backed economic stabilisation plan which tamed hyperinflation in the 1980s.

The new hydrocarbons minister, Andrés Soliz Rada, a left-wing journalist, will lead negotiations with foreign gas companies. He must try to reconcile Mr Morales's demand for nationalisation of gas with his promise to protect investors' right to profits. Abel Mamani, who led a rebellion to expel a privatised water firm from El Alto, a poor township near La Paz, is the water minister. He has a pragmatic streak.

The cabinet shows that what Mr Morales “really believes is that he has an opportunity to lead a revolution in Bolivia,” argues Roberto Laserna of the University of Cochabamba. For that, “you don't need administrators”. Alternatively, he wants to placate the social movements, which have brought down two presidents since 2003, in order to pursue pragmatic policies they would otherwise resist.

It is too early to tell. Mr Morales has signed eight agreements with Mr Chávez. Venezuela will quadruple diesel exports to Bolivia to 200,000 barrels a month and offer political advice, in exchange for Bolivian commodities. But Mr Morales has asked for help from other quarters too.

Bolivia's future may become clearer after a constituent assembly is set up in August. Its job is to “refound” the country, says Mr Morales. He claims to be leading a “democratic revolution” in a

poor and unequal country. But will the stress turn out to be on democracy—or on revolution?

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Trinidad & Tobago

Having their days in court

Jan 26th 2006 | PORT OF SPAIN
From The Economist print edition

An anti-corruption drive running on Caribbean time

BARBADIANS and others like to complain about “tricky” Trinidadians. But many other countries in the English-speaking Caribbean have had more than their fair share of eye-catching corruption scandals. What marks out Trinidad & Tobago is its zeal for prosecuting those alleged to have abused the public trust. No fewer than eight former ministers currently face criminal charges.

The most senior is Basdeo Panday, the prime minister from 1995 to 2001 and now the opposition leader. He was charged in September 2002 with failing to include a London bank account in a statutory declaration of his assets filed to the country's Integrity Commission. He faces a possible prison sentence.

The magistrate in the case has yet to hear any evidence. For three years, Mr Panday's lawyers have tied the legal system in knots with procedural objections. On January 23rd, he once again had his day in court—three times over, with procedural hearings before the magistrate, the appeal court and the high court. None did anything more than set a date for a new hearing. Three disconsolate British bank officials sat in court, flown out fruitlessly to testify. Next stop is the Privy Council in London, on February 16th.

Five of Mr Panday's cabinet colleagues and two ministers from the current government of Patrick Manning also face charges. A former finance minister was charged in March 2002 with wrongdoing over a new airport terminal. After 124 court sessions and a roomful of written evidence, the magistrate may rule within a few months on whether the case should proceed. But it is unlikely to be concluded before an election is due next year.

Trinidad's oil and gas industry provides scope for corruption. There is a cultural tradition of small-scale graft. Politicians have at least recognised the problem, setting rules for disclosing wealth. Some officials claim that these rules are too time-consuming and violate privacy. Mr Panday's lawyers argue that enforcement is uneven. To their credit, enough Trinidadians have been troubled by abuses to blow whistles. In 2002, corruption claims were the main reason the voters turned against Mr Panday. But if all that this produces is a never-ending legal circus, rather than verdicts either way, the risk is that Trinidadians will give up worrying about corruption and focus on Carnival.

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Thailand

Thaksin helps himself

Jan 26th 2006 | BANGKOK AND HONG KONG
From The Economist print edition

A politically and economically astute asset sale by the prime minister

EPA

ACCORDING to Thaksin Shinawatra, Thailand's prime minister, his relatives' decision to sell their stake in Shin Corporation, the conglomerate he transferred to them on taking office, was an act of patriotic self-sacrifice. They hope their deal with a consortium led by Temasek, an investment arm of the Singaporean government, will put an end to the constant complaints about Mr Thaksin's conflicts of interests, and allow him to concentrate on running the country. But this noble deed also netted the family 73 billion baht ($1.85 billion), and allowed it to dispose of its telecoms empire just as the sector enters a period of regulatory uncertainty. In his explanation of the sale, at any rate, Mr Thaksin seems guilty of what his critics always accuse him of: confusing the national interest with his family's.

Mr Thaksin's business empire has caused him plenty of political headaches over the years. He almost lost the top job just after taking it up in 2001, when the constitutional court demanded to know how shares belonging to him had shown up in the hands of his gardener and driver, rather than on the mandatory statement of assets he had made during a prior stint as a minister. After that, every time his government made a decision affecting telecom firms, airlines, television channels, finance companies or any of the other industries in which Shin Corp had invested, critics would cry foul. By removing the Shinawatras from all these businesses, the deal should stem such carping.

But the potential for conflicts of interests has only been reduced, not eliminated. Mr Thaksin's cabinet includes several other prominent businessmen, and has no formal procedures to guard

against self-serving decisions. The Shinawatras themselves still hold stakes in an advertising agency. The press is already speculating about where they will invest the proceeds from the sale of Shin Corp. But wherever the money ends up, the family's unnerving combination of immense political and economic power will remain.

Moreover, Mr Thaksin has endured accusations of impropriety with little apparent discomfort over the past few years. Although the subject has the pundits of Bangkok up in arms, it does not seem to move the voters very much. They returned his party to office last February by the biggest margin in Thai electoral history. Admittedly, city-dwellers have cooled to him dramatically since then. But his populist flair still seems to sway his vast numbers of rural supporters. Just last week, he starred in his own reality TV show, in which cameras accompanied him around an impoverished village, as he dispensed advice, cash and plots of land to grateful peasants (see picture above).

But whatever the political ramifications of the deal, the commercial logic is unimpeachable. The Shinawatras sold out with the share price of Shin Corp at an 11-year high. Tougher times lie ahead for Advanced Info Service (AIS), the mobile-phone offshoot that accounts for around 90% of Shin Corp's value. Growth in Thailand's mobile market has slowed from more than 100% a year in 2002 to 11% last year, with Nomura, a Japanese investment bank, forecasting future expansion of only 5% a year. Other providers are chipping away at AIS's market share.

Probably the biggest spur to a sale, however, is the uncertainty inherent in Thailand's strangely structured telecommunications industry. In most countries, telecom firms build networks under licences. In Thailand, the private-sector players—two fixed-line and five mobile ones—have merely been granted operating concessions of between 15 and 27 years by the state-owned telecoms duopoly, Telephone Organisation of Thailand and CAT Telecom. Thailand's constitution, enacted in 1997, mandates an independent regulator to reform this odd set-up. Various procedural problems have held the process up—something that did not appear to worry Mr Thaksin's government very much—but the National Telecommunications Commission is now at last up and running. It should soon rule on vexed issues such as interconnection fees between rival networks, and will eventually decide what becomes of the private concessions. Faced with such an upheaval, the Bencharongkul family, which owned a stake in TAC, the number-two mobile provider, sold out to Norway's Telenor last year. Now the Shinawatras are following suit.

It is into this regulatory minefield that Temasek is venturing. To its credit, Singapore's government investment agency has deep pockets and experience of telecoms and technology, which along with transport and financial services is one of its main areas of expansion. Temasek controls Singapore Telecom, the city-state's main telecoms firm, which already owns a separate 21.4% stake in AIS. At just 45%, Thailand's cellular penetration is far below Singapore's 90%-plus, offering prospects for growth. Having said that, Temasek is paying a fairly expensive 15 times prospective 2006 earnings for Shin Corp.

Temasek's total annual shareholder return has dropped to only 6% for the past ten years. As a result, the agency is under pressure to diversify its investment portfolio outside its home city. The Shin Corp deal takes the foreign portion to 55% of the total. The Shinawatras' patriotic urges, it seems, coincided neatly with their and Temasek's business interests.

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Nepal

The ballot and the bullet

Jan 26th 2006 | BANEPA AND KATMANDU
From The Economist print edition

A year after his coup, King Gyanendra does it again

IN MANY nasty dictatorships, people take to the streets to demand an election. In Nepal, they want to stop one. Popular demands differ, but dictators tend to react the same way. Before a big demonstration planned for Katmandu on January 20th, a curfew was imposed, armed soldiers patrolled the streets and hundreds of people, including political leaders, were detained without trial. King Gyanendra's security forces used the same tactics, including the cutting of mobile-phone connections, when he seized absolute power for himself on February 1st last year.

This year, the king's government lifted most restrictions after a weekend of street fighting in the capital, and freed some detainees. It offered talks to released politicians. But they were rejected, as an effort to divide and rule, and the government insisted the elections would go ahead. They are to be held on February 8th in 58 municipalities, covering 43 of Nepal's 75 districts. They are a first step in the king's professed plan to restore democracy, to be followed by national elections next year. This is an ambitious aim, since in most districts the government's writ barely extends beyond its headquarters. Most of the countryside is prey to intimidation and violence from Maoist insurgents.

The country's seven biggest political parties—including an avowedly royalist one—are urging a boycott. They argue that the insurgency, which marks its tenth anniversary next month, makes elections impossible. They see the polls, accurately, as an attempt by the king to disguise his autocracy, placate international opinion and marginalise them.

Last November, while the Maoists were observing a unilateral four-month ceasefire, which was not reciprocated by the royal army, the parties entered an alliance with them against the king. Madhav Kumar Nepal, leader of one of the big parties, the Unified Marxist-Leninist (UML), says he did not even try to persuade the Maoists to extend their ceasefire, which they called off on January 2nd. The Maoists' leader, known as Prachanda, said that the targets of renewed military action would be “the royal army and its hired informers that are going to stage a drama of so-called municipal elections”. On January 22nd, an electoral candidate in the town of Janakpur was murdered.

An aide to the king has said that the elections will go ahead “irrespective of how many people die”. If so, they may be a bloody farce. Only 24 kilometres (15 miles) from the capital, for example, preparations in Banepa, a drab highway town of 12,000 voters, are proceeding badly. Officials boast that there are four mayoral candidates, but one of them has decided to withdraw after receiving a letter from the Maoists, and another is on the verge of pulling out under pressure from his family. Shambu Koirala, the chief official in Dhulikhel, the district headquarters, denies there are problems. The last time local polls were held, eight years ago, turnout was over 70%. This time he has been ordered by the government to do even better, though he was not helped by a bomb blast in Dhulikhel on January 24th.

The political parties are doing their best to poison the atmosphere, threatening candidates with ostracism. They called a national strike—a form of protest often enforced by thugs—for January 26th, the day candidates were due to register. Buoyed by some big rallies, the parties and democracy activists are optimistic that a “people's movement” has begun that will topple the monarchy—or shrink it to a modest, symbolic role. The parties' popularity was boosted by the agreement with the Maoists, which, by accepting them into the political mainstream, may hold the promise of peace. But their campaign has not achieved unstoppable momentum.

The Maoists last year suffered a serious leadership split. But their officials' adherence to the ceasefire showed discipline and unity. Now, though, countering the army's propaganda about their alleged weakness, they have stepped up their campaign of violence, bringing it closer to Katmandu. The insurgency has taken more than 80 lives this month. The Maoists have called a week-long strike of their own around polling day.

The UML's Mr Nepal, who was detained last week, says the Maoists know they can neither win nor be defeated by the gun. The same goes for the royal army, though the king may not agree. To some, he seems under greatest pressure from the Maoists and the pro-democracy forces. But others think he may be more responsive to his own main body of support—Nepal's small but powerful group of far-rightists, who complain not that he has suppressed dissent, but that he has not done so thoroughly enough. Following their advice, he has painted himself into a corner, from which extrication will be messy.

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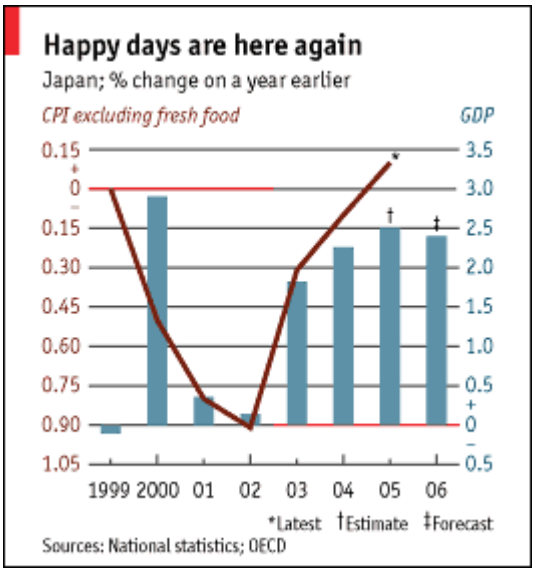
Japan

Locking in the legacy

Jan 26th 2006 | TOKYO
From The Economist print edition

There's still no alternative to the Koizumi doctrine



YOU would think the man had never heard of lame ducks. Fewer than nine months before Junichiro Koizumi is due to quit as leader of the ruling Liberal Democratic Party (LDP) and so as prime minister, his bandwagon keeps rolling. Last week, giving his policy speech at the annual opening of the Diet for the last time, he promised an agenda full of reform. The intention this session, he said, is to revamp welfare and pension schemes, to shrink the number of civil servants, to decentralise government to newly revamped localities, to start privatising public services and to privatise or consolidate eight government-linked financial institutions.

By June, moreover, the government will be able to lay out how it is to put its fiscal affairs in long-term order after years of big budget deficits. All wonderful stuff. And Mr Koizumi is able to make such claims because his popularity is still high and his political authority continues unchallenged by backroom dealings since he engineered a landslide general-election victory for the LDP last September. The election was fought over the issue of reform, notably the privatisation of the postal system. “With momentum from postal privatisation,” Mr Koizumi promised, “I will continue reforms to create a simple and efficient government.” He is retiring only because he has run up against the LDP's own term limit for its leader.

For how many more months can his authority remain unchallenged? A faint whiff of vulnerability came this past week, with a scandal that has broken over a company called livedoor, a high-profile internet and finance business under investigation for murky dealings including alleged stockmarket manipulation and accounting irregularities. Mr Koizumi has no direct ties with either the company or its loud-mouthed young founder, Takafumi Horie, who has just been arrested (see article). But in last September's election Mr Horie ran—and lost—as an independent in support of Mr Koizumi and his reform agenda. The prime minister's point man on structural reforms, Heizo Takenaka, went down to Hiroshima to campaign for Mr Horie—something that now looks like a lapse of judgment. Mr Horie is fast becoming the symbol of all that can go wrong with rapid reforms.

If the livedoor scandal can be contained, then Mr Koizumi's writ can be expected to extend at least until March, when the budget is meant to be passed, and probably well into the summer. At some point, of course, public attention will shift from Mr Koizumi to the contest within the LDP to succeed him. But even by then, Mr Koizumi expects, he will have set the agenda: he insists that potential candidates should be judged by their commitment to reforms that allocate economic resources more efficiently in Japan.

Mr Koizumi's last months coincide with accelerating economic growth and a definitive end to seven years of grinding deflation—in November core prices rose by 0.1%, and a positive core inflation rate for December is also expected to be announced on January 27th. The prospect has recently drawn the central bank into the political line of fire, for the Bank of Japan is contemplating, by late spring or early summer, winding down its practice of flooding the banking system with excess liquidity, a policy known as “quantitative easing”, introduced in 2001 in an attempt to break deflation. Sometime later, as the gap narrows between what the Japanese economy is capable of producing and what it is actually producing, the bank wants to end its policy of keeping interest rates, in effect, at zero. Yet some politicians, including Mr Takenaka, have threatened to curtail the bank's independence if it tightens monetary policy before politicians deem it safe to do so—perhaps by forcing an inflation-targeting regime on it.

Though to some this looks like dangerous bullying of the Bank of Japan, the debate is actually a healthy one, says Robert Feldman, chief economist at Morgan Stanley in Tokyo. Japan's fiscal problems, the need to allocate resources better in the economy and the risks of deflation: all need to be considered together. It is possible to see the outlines of an agreement, where the bank accepts the need for some kind of inflation targeting, along with the understanding that it will not raise interest rates soon if the government continues to push reforms and tackle spending. Such an agreement, in other words, could help keep the Koizumi bandwagon rolling.

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Australia

Wheat scandal

Jan 26th 2006 | SYDNEY
From The Economist print edition

Embarrassment for John Howard

EPA

FEW countries denounced the regime of Saddam Hussein in Iraq more loudly than Australia, which was also one of the first to commit troops to the American-led invasion of the country three years ago. An inquiry that is just hitting its stride in Sydney has uncovered a seamier side to Australia's idealism. While the conservative coalition government, led by John Howard, was calling on Iraq to behave like a respectable international citizen, AWB, the company responsible for selling Australia's wheat, is suspected of paying illegal kickbacks to Mr Hussein's regime to secure contracts under the UN's oil-for-food programme. It is turning into one of Australia's biggest-ever corruption scandals.

The inquiry's trigger came from a report last year by a UN committee headed by Paul Volcker, a former chairman of the Federal Reserve, that included AWB among companies that had made payments to the Iraqi government. AWB denies the claims, and says it had no idea that the Jordanian company which it paid to distribute its wheat in Iraq was in fact remitting the money to the government.

According to the Volcker report, AWB paid over $221m to the Jordanian company, Alia, between 1999 and 2003. And it cites documentary evidence that suggested that at least some of the company's staff had evidence that some of the money paid to Alia was for the benefit of the Iraqi government, a clear breach of UN resolutions. AWB was listed in 1999; until 1997 it was the publicly-owned Australian Wheat Board; it retains the old board's monopoly on selling Australia's wheat. Between 1999 and 2003, AWB sold Iraq wheat worth more than $2.3 billion.

Precisely what AWB did, and who knew about it, is unfolding at a royal commission of inquiry that opened in Sydney on January 16th. Terence Cole, the former judge conducting the inquiry, has indicated he may use his wide investigative powers to shed light on how much government officials and ministers knew.

In July 2002, Alexander Downer, Australia's foreign minister, accused Mr Hussein of developing weapons of mass destruction. Soon afterwards, Iraq said it would cut its wheat purchases from Australia. Andrew Lindberg, AWB's managing director, flew with other executives to Iraq and struck a new deal. The Sydney inquiry has heard evidence that this may have included acquiescing in Iraq's demand for $1.5m in compensation for a wheat shipment that Iraq alleged was contaminated. Mr Lindberg, among others, believed this claim was a ruse to punish Australia for its pro-American stance.

Mr Howard congratulated AWB in 2002 for doing “a very good job” after it won Iraq back as a customer. He is now distancing himself from a company whose reputation the inquiry is questioning intensely. At the least, the revelations have embarrassed his government.

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China

'Tis the season

Jan 26th 2006 | BEIJING
From The Economist print edition

Happy lunar new year

IN THE broad scheme of things, it may rank low on the list of problems Chinese people have to complain about, but bans on fireworks, enacted throughout the 1990s in hundreds of Chinese cities, drew widespread scorn. In response to popular pressure and to the delight of many, most bans have since been lifted. This year Beijing has removed its 12-year ban as well. When the Year of the Dog dawns on January 29th, the capital will greet it in the traditional, cacophonous, style. For some, fireworks are a solemn matter of superstition: the sound and light show is believed to scare away evil spirits and ensure an auspicious good year. For others it is merely a way to share in a centuries-old tradition.

Other spring festival traditions remain very much intact. Except for restaurants, stores and travel services, business comes to a standstill as people focus on family gatherings, temple fairs and, above all, feasting. Getting all those families together requires an astonishing logistical exercise. Transport officials expect to see a total of 2 billion journeys in the 40-day period surrounding the holiday. Train stations have become madhouses as people wait days on end for tickets. Buses and aircraft are likewise filled to bursting.

Among the cramped and cranky travellers are the estimated 100m migrant workers who leave their rural homes to take menial jobs in cities across China. Though they are often looked down upon by the city folk they live among for most of the year, they are sorely missed during the holiday period when people like street sweepers, delivery boys and bicycle repairmen are suddenly in short supply.

One unwelcome feature of the holiday period is an annual spike in petty crime, attributed to migrant workers who are under great pressure to return home flush with cash. Those who didn't earn it (or manage to hold on to it) are easily tempted to grab it where they can.

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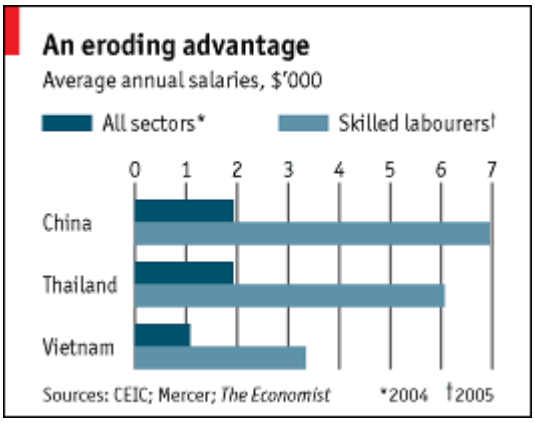
Vietnam

Trouble at the mill

Jan 26th 2006 | HANOI
From The Economist print edition

Strikes and pay rises afflict the new South-East Asian tiger



FACTORY workers in Vietnam have an extra reason to celebrate Tet, the lunar new year holiday that begins this weekend. Their government recently decided to raise the minimum wage in foreign-owned factories by up to 40%, starting on February 1st. Pay packets in Hanoi and Ho Chi Minh City will now start at $45 a month, the first mandated rise in several years. Experienced workers can expect an extra 7% increase on top of that.

What is especially unsettling for investors is how the workers got their extra dough. Since late December, wildcat strikes have swept through the industrial zones surrounding Ho Chi Minh City. Tens of thousands of workers joined the protests over wages and conditions. Some of these turned violent, and machines were wrecked at one Taiwanese-owned plant. Bosses claim that outside agitators stoked the protests, distributing notes at factory gates while police stood idly by.

Apparently caught off-guard, the government issued a decree earlier this month raising the minimum wage in foreign-owned factories. Most strikers have now returned to work, but some have not, and investors are fuming over production stoppages and a higher wage bill. The European Chamber of Commerce has gone so far as to write a tart letter to the prime minister, Phan Van Khai, reminding him that investors set up shop in Vietnam precisely because “the workforce is not prone to industrial action”.

At least, not until now. Workers in Vietnam have staged walkouts before, particularly over alleged mistreatment by foreign managers, but the scale and co-ordinated nature of the latest strikes are, well, striking. Some observers find it implausible that they could occur without the prior knowledge of the ruling party, which forbids independent trade unions. As in China, workers are allowed to join only a pliant, party-affiliated union.

Most of the affected factories are owned by East Asian companies, the biggest investors in Vietnam. At Song Than industrial zone, on the outskirts of Ho Chi Minh City, 80% of the factories are owned by Taiwanese, producing clothing, shoes, furniture and bicycles for export. They grumble that higher wages will drive away foreign investment, running at $5.8 billion last year, and give warning that Vietnam needs to stay competitive. “Chinese wages are higher. But the quality and efficiency are also higher,” said Chen Chi Young, an official at Taiwan's de facto embassy.

So why didn't Vietnam crush the illegal strikes? One reason, say observers, may be internal

jockeying ahead of the party congress in April, a five-yearly affair. The aim could have been to embarrass the provincial officials where the unrest began, or to burnish the leadership's credentials, or both. The factories most affected may also be a clue: Vietnam and Taiwan both claim ownership of the Spratly Islands, along with several other countries. On December 15th, Taiwan said it was building a landing strip on one of the islands.

Or perhaps the workers were simply fed up with low pay and stingy bosses, and were too numerous to repress. Vietnam has one of the world's fastest growing economies. Now it is learning that higher output means higher expectations.

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Palestine and Israel

The dilemma over Hamas

Jan 26th 2006 | HERZLIYA AND JERUSALEM
From The Economist print edition

Reuters

What will the Islamists of Hamas do with their claimed victory in the Palestinian elections, and how will Israel and the world respond?

BELYING fears of violence, Palestinians voted peacefully and numerously for a new parliament on January 25th. While exit polls had pointed to a narrow victory for Fatah, the ruling party in the Palestinian Authority (PA), unofficial early counts, as *The Economist* went to press, gave its Islamist rival Hamas some 70 seats of the legislature's 132. The PA cabinet, which has to be reappointed after the election, resigned pre-emptively at the looming possibility of an outright victory for Hamas.

However, if neither party gets more than half the seats, one of them will have to form a coalition with some of the smaller parties. These tend to lean towards the secular Fatah party, though a couple may see benefits in siding with Hamas. Yet even if Hamas has won outright, it will try to avoid the showdown—with Fatah, Israel and the rest of the world—that would result from taking over the PA. A Hamas leader said that it would not form a government alone, but seek one of national unity with other parties. Mahmoud Abbas, a Fatah man, remains the Palestinian president and will still get to appoint the cabinet.

Most Palestinians still prefer compromise with Israel and oppose *sharia* law, thus going against two of Hamas's core tenets. So Hamas may start by demanding uncontroversial ministerial posts, such as health or public works, that showcase its reputation for efficiency and clean hands. The party campaigned mainly on domestic issues such as corruption and welfare.

But the world will also watch closely how Mr Abbas treats the rival streams in Fatah. Judging by the past, he will try to strike a balance between unpopular Arafat loyalists and their upstart rivals who briefly split the party just before the election. Who gets which job will determine whether the PA can start to work effectively or stays hamstrung by internal feuding. Hamas's participation could add to the deadlock, or help end it.

All this will determine how willing foreign donors are to work with the PA. It needs their help to avert a looming fiscal crisis, bring the security services under a single chain of command, crack down on lawlessness and get development projects going in Gaza. But, despite warnings from both the United States and the European Union that they cannot work with a PA run by Hamas, their relations with one that contains Hamas ministers will probably not change drastically for now.

How Israel's relations with the PA will change is more important and less predictable. This week at the annual Herzliya conference, a gathering for Israeli movers and shakers, the mood was belligerent. This was partly because the participants' list was replete with flinty-eyed generals and senior intelligence types. But it also reflected a wider sense that Israel is living through a dangerous time in the Middle East: a strong showing by the Muslim Brotherhood (Hamas's antecedents) in recent parliamentary elections in Egypt, unstable regimes vulnerable to extremist influence in Syria and Lebanon, the threat of Iran developing nuclear weapons—and now the rise of an Islamist Palestinian party that, despite surprisingly moderate statements from several of its leaders in the run-up to the election, officially still calls for Israel's destruction.

The view that Hamas might be persuaded gradually to abandon armed struggle for politics, as Irish Republicans have over the past few years, gets short shrift here. A commoner model is Hizbullah, the Lebanese group which has roles in parliament and government but retains its armed wing—something that would, in Hamas's case, rule out Israel's agreeing to talks with the PA. Uzi Arad, a former senior Mossad man who runs the Herzliya conference, paints an even more apocalyptic picture: Hamas as the Nazi party in the 1930s, democratically brought to power but gradually adopting ever-more repressive, undemocratic policies.

Still, Israeli views vary. Ehud Olmert, the acting prime minister, has asked for two separate sets of proposals on Hamas: one from his more hardline intelligence and defence chiefs, another from the national security adviser, Giora Eiland, who is said to favour seeking out Hamas's moderate elements.

But Israelis are predisposed to pessimism. Mr Olmert surprised no one in Herzliya by hinting that if peace talks fail, Israel would continue the trend begun by his ailing predecessor, Ariel Sharon: unilateral withdrawal from occupied territory to rid itself of responsibility for the Palestinians, while setting whatever borders it sees fit for its own security. More notable was that Amir Peretz, who on his recent election as Labour Party leader said he would rapidly bring about peace through peace talks, this week hinted at the unilateral option too.

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Iraq

Time for that sea change

Jan 26th 2006 | DUBAI
From The Economist print edition

With a new parliament in place, the drive for a unity government has begun

Get article background

AP

Hakim wants power, with help from above

NOW that Iraq's election commission has broadly endorsed the results of mid-December's general election, negotiations between parties speaking for Iraq's three main groups—Shia Arabs, Sunni Arabs and Kurds—have begun in earnest, with the Shias informally airing the names of four of their number for the post of prime minister. Sectarian killings continue to complicate such dealings. But, for the first time in weeks, American diplomats in Baghdad sound cautiously hopeful that a sea change in Iraqi and particularly Sunni politics is nigh. They are encouraged, too, by reports that the nationalist and al-Qaeda-minded groups of insurgents have started sporadically to fight each other, even carrying out tit-for-tat assassinations.

A month after Iraqis voted to elect their first permanent parliament since Saddam Hussein's ousting nearly three years ago, the country's independent electoral commission finally announced the results. As expected, the Shia-led United Iraqi Alliance (UIA), which dominated the previous year-long transitional government, easily won, taking 128 out of 275 seats, with 41% of the votes cast, down only slightly from its near-majority in January 2005. A Kurdish alliance of two main parties took 53 seats and 22% of the vote, also down a bit from last January's total. Finally, the two main Sunni-led coalitions took 55 seats and 19% of the vote between them, a big gain on the 17 seats the country's former ruling minority won a year ago, when most Sunni Arabs abstained.

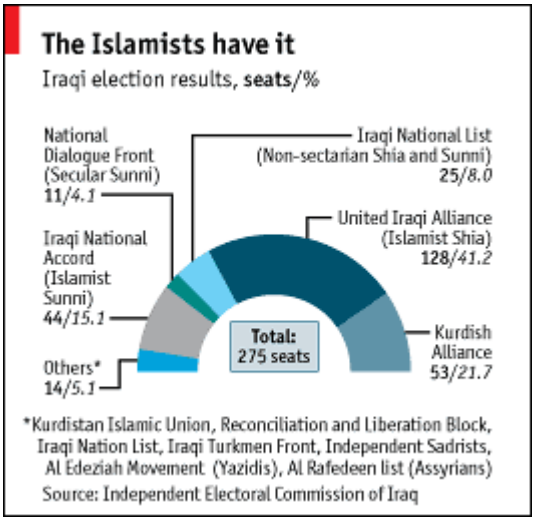
The Americans and their allies were disappointed, however, by the poor showing of secular-leaning parties; most voters cast their ballots along ethnic and sectarian lines. An alliance led by a former prime minister, Iyad Allawi, a tough, secular-minded Shia, took only 25 seats (8% of the vote), while the Iraqi National Congress, headed by Ahmed Chalabi, whom leading neo-conservatives in Washington had once hoped to see as prime minister of a new Iraq, failed to win a single seat, getting less than 0.3% of votes cast.

The final count took so long (five weeks) because the poll's validity was disputed. Sunni Arabs and secularists had cried foul, saying that UIA supporters had threatened voters and stuffed ballot boxes in Baghdad and the Shia south. At times, the aggrieved parties demanded a revote and threatened to abandon the political arena altogether. In the end, however, the electoral commission said they would invalidate fewer than 1% of the ballot boxes due to irregularities. A number of international institutions, including the United Nations, declared the poll free and fair enough. The Sunni Arabs, though still grumpy, may have accepted the result largely because they

believe the Bush administration wants to help them in negotiations for decent representation in a coalition government.

On paper, the Shias and Kurds could recreate last year's coalition government, as their combined tally falls only a few seats short of the two-thirds necessary to appoint a presidency council, the first step in forming a government. But this would incense the Americans, who want a unity government to draw Sunnis into peaceful politics and away from the insurgency. The Americans also want to persuade the Sunnis that the Shias, especially the Iran-backed Supreme Council for Islamic Revolution in Iraq (SCIRI), will not dominate the security services: many insurgents say they are fighting a war of self-defence against Tehran. America's ambassador, Zalmay Khalilzad, has given warning against the reappointment of a “sectarian” (in fact, SCIRI) interior minister: “We're saying, if you choose the wrong candidates, that will affect [American] aid.”

Most Iraqi parties pay at least lip service to the need for a unity government. The Kurds seem fairly happy with a handful of ministries, with Jalal Talabani, leader of the Patriotic Union of Kurdistan, one of their two main parties, as Iraq's president. And they may genuinely think that bringing some credible Sunni Arab leaders into power would be a good idea.


The Islamists have it
Iraqi election results, seats/%
National Dialogue Front (Secular Sunni) 11/4.1
Iraqi National List (Non-sectarian Shia and Sunni) 25/8.0
United Iraqi Alliance (Islamist Shia) 128/41.2
Iraqi National Accord (Islamist Sunni) 44/15.1
Total: 275 seats
Kurdish Alliance 53/21.7
Others* 14/5.1
*Kurdistan Islamic Union, Reconciliation and Liberation Block, Iraqi Nation List, Iraqi Turkmen Front, Independent Sadrists, Al Edeziah Movement (Yazidis), Al Rafedeen list (Assyrians)
Source: Independent Electoral Commission of Iraq

The Shias, however, do not yet sound in a mood to make such compromises. SCIRI's head, Abdelaziz al-Hakim, has said that placing Sunnis “in this or that post” would not have much effect on the insurgency. Instead, “the important thing is that they [the Sunnis] believe there is a new reality in Iraq”: ie, that rule by the Shia majority is there to stay. Followers of Muqtada al-Sadr, a firebrand Shia cleric who, after flirting with the Sunni insurgency, is now a full-blooded member of the Shia coalition, are equally determined that Shias should keep control over Iraq's security forces. Both SCIRI and the Sadrists have strong militias which Iran is thought to support, so they may not be especially rattled by American threats to make some kinds of military help conditional.

But the Shia front may be weakened by rows between different parts of the UIA: SCIRI, the Sadrists and the Dawa (Islamic Call) party. Many Iraqis, particularly Mr Talabani's Kurdish followers, think the current prime minister, Ibrahim al-Jaafari, the Dawa leader, has been ineffective, and favour Adel Abd al-Mahdi, a relatively liberal SCIRI man. Dr Jaafari, however, has lobbied hard to keep his job, and has the support of the Sadrists, who detest SCIRI. If Dawa keeps the prime minister's post, then SCIRI will probably insist on holding on to the interior ministry. But that, in turn, would enrage the Sunnis, who blame the present SCIRI-dominated interior ministry for a string of assassinations of prominent Sunnis.

Reports of increasingly bad blood between nationalist and extreme Islamist insurgents are fuzzier but, in the eyes of those trying to establish a peaceful new order, more promising. Many nationalist insurgents have apparently been appalled by two recent attacks on Sunnis trying to join the security forces with the blessing of local tribal sheikhs, which left a total of more than 100 dead. They may try to drive the radicals out of former fundamentalist strongholds such Ramadi. And once the new Sunni MPs take up their seats in parliament, some of the insurgent groups may use them as a conduit for putting their demands on a national agenda. If their voices are better heard, then—the hopeful logic goes—they may forsake their guns and bombs, and help a unity government to regain control of the country.

Kenya

Caught in the act

Jan 26th 2006 | NAIROBI AND OXFORD
From The Economist print edition

A courageous investigator uncovers more corruption in Kenya. But will the government, or the country's president, be shamed into taking action?

AP

Hot stuff from Githongo

IT BEGAN in early 2003 with a second-hand car. Though battered by Nairobi's bad roads, its owner, a top Kenyan civil servant, was trying to sell it as new to his chum's ministry. It was a small scam. But John Githongo, the permanent secretary for ethics and governance in the newly-elected government of Mwai Kibaki, feared worse was to come. This was the sort of impunity Mr Kibaki had sworn to end, after replacing the kleptocratic regime of a veteran dictator, Daniel arap Moi.

Mr Githongo, an expert on corruption and a former Nairobi correspondent for *The Economist*, was correct. Over the next two years, he watched as the government emulated its crooked predecessor. He alleges it signed $300m-worth of dubious or fraudulent contracts in the security sector alone. It also inherited $400m-worth of such contracts from Mr Moi's government, and honoured them. Mr Kibaki's most trusted ministers told Mr Githongo the cash was needed to smooth the passage of a new constitution—which Kenyans rejected in a referendum in November—and to win elections due next year.

Mr Githongo fled to Oxford University last February, after receiving death threats. In November, he sent a 36-page summary of his investigations to Mr Kibaki—whom he had briefed on them during his time in office—and to the Kenya Anti-Corruption Commission (KACC), a hitherto ineffective investigative body. When neither responded, Mr Githongo passed his dossier to a Kenyan newspaper, the *Daily Nation*; on January 22nd it began exposing the contents. Perhaps not coincidentally, the KACC had stirred itself a few days before, summoning 30 people for questioning, including the vice-president, Moody Awori, and two ministers fingered in Mr Githongo's dossier. Western diplomats in Nairobi, who for years had watched Kenyan politicians gobble aid money, briefed foreign journalists on the scandal. The furore has been impressive.

On radio and television, Kenyans lambasted Mr Kibaki and his inner circle—all of them members of his Kikuyu group and known as the “Mount Kenya mafia”. Opposition politicians, predictably, urged the government to resign. That is unlikely to happen, not least because Kenyan MPs are among the world's best-paid. But Mr Kibaki, of whom Kenyans expected much, looks weak and discredited. His Rainbow Coalition had already split during the referendum campaign; its non-Kikuyu members, led by an adept populist, Raila Odinga, a Luo, have formed a new opposition alliance. And Mr Kibaki is now accused of failing to stop massive fraud, or hunt the perpetrators. Referring to the scams outlined in his dossier, Mr Githongo said the president “was briefed about these issues all along.” His revelations provide a unique insight into top-level looting in one of the

world's most corrupt countries.

Corruption in Kenya is not natural-resource driven, as in other African countries. The Goldenberg scandal, which cost Kenya perhaps $1 billion in the 1990s, involved the illegal export of fictitious gold and diamonds, not real ones. At high levels, corruption involves ministers and civil servants paying as much state cash as possible for shoddy goods or services never rendered.

Shoddiness is the key. Kenyans' weary tolerance of third-rate goods allows large margins on corrupt deals. This is especially true of arterial transport. The road from Mombasa, on the Indian Ocean, to Kampala, Uganda's capital, is potholed and dangerous. The rolling stock of the railway running along the same route has not been upgraded for decades, despite frequent infusions of government cash. Such is the general decrepitude of the state, and rapacious fleecing of businesses by the bureaucracy, that it costs more to ship a tonne of grain from Mombasa to Kampala than from Chicago to Mombasa.

Dishing the dirt

Central to Mr Githongo's allegations is a contract negotiated in December 2003 by senior civil servants, to pay $37m for secure passport equipment, previously valued at $10m. The deal was to be financed, at 4% interest, and the equipment obtained by a company registered in Britain, Anglo Leasing and Finance (ALF). By early 2004, the government had paid ALF $1.17m on this contract. In 2001, Mr Moi's regime had signed another contract with ALF, to finance and obtain a forensic police laboratory for $59m. Though no work had been done on the laboratories, the government had paid ALF $5m on this deal.

Alerted to the two deals in April 2004, Mr Githongo swiftly established that the company did not, in fact, exist at the three addresses given for it in Britain and Switzerland, and that no Kenyan official involved in the deals admitted to knowing the identity of the company's directors or investors. At an address given for the company in Liverpool was a small property company, Saagar Associates, which was owned by a member of the Asian-Kenyan Kamani family, with strong business links to Mr Moi's regime. Another company owned by members of the family had gained notoriety for providing the Kenyan police with 1,000 crummy Mahindra jeeps at inflated prices. Saagar Associates claimed to represent ALF; one of its directors had signed contracts on ALF's behalf.

Mr Githongo briefed Mr Kibaki on his investigations. His dossier records him informing the president that some of his closest advisers were prime suspects in the affair. Then in early May an odd thing happened: the money paid to ALF was repaid to the central bank. Several weeks later, a Swiss man, Michel Gruring, who said he was ALF's managing director, announced that the contracts had been cancelled.

Shortly after, $6.3m was repaid to the central bank by a company called Infotalent Ltd, which had been contracted to provide communications kit to the police, and about which Mr Githongo had made preliminary inquiries. Mr Githongo alleges it was also a shell company. In July, another company, Silverson Forensic, repaid $910,000 from a bank in Liechtenstein, and cancelled a contract to finance and supply police vehicles. Mr Githongo says he was told that both repayments were made after the government contacted a prominent Nairobi businessman.

Whoever was behind the contracts had hit on quite a clever scam. By entering into a contract with an entity that did not, in any real way, exist, the government had no legal recourse if its promised goods or services did not arrive. Moreover, it ensured the government would be obliged to service its “debt” to the company, though it had received nothing in return, and though the company had not, in fact, extended any finance on its behalf. In effect, the government was paying interest on

loans to itself, in order to secure goods or services at inflated prices. Crucial to the model's success were the unscrupulous businessmen who registered the bogus companies and handled the cash.

Though pleased, no doubt, to have recovered $12m of public funds, Mr Githongo had reason to stay zealous. On May 14th 2004, around the time ALF began repaying, the governor of the central bank, Andrew Mullei, wrote to a civil servant in the finance ministry, Francis Oyula, seeking confirmation that he should continue making payments on $600m-worth of contracts in the security sector, signed with 17 companies between late 2001 and early 2004, including ALF. Mr Oyula replied authorising payments on most of the contracts and promising further authorisations. According to Mr Githongo, several of the companies were mere shells, like ALF. Others existed, but the government had promised to pay well over the odds for their goods. One of these was allegedly a foreign company contracted to supply a naval vessel for $57m, which had subcontracted the task to a Spanish ship-builder. The ship, according to one diplomat in Nairobi, is little more than “a civilian ship with grey paint.”

Mr Githongo says he was informed on several occasions by the then justice minister, Kiraitu Murungi, that senior members of the government were behind the ALF scam and others; Mr Murungi allegedly told him that the culprits were, in short, the government itself. He said the minister claimed the money would be used to fund election campaigns, and was being managed by Chris Murungaru, the then minister for internal security. According to Mr Githongo, Mr Murungi urged him to end one of his investigations. If he did so, Mr Murungi allegedly suggested, a debt held by Mr Githongo's father with a local businessman, whom Mr Githongo was investigating, would be forgiven. Mr Murungi denies all this. He said this week that he was not involved in the ALF contracts; did not try to impede Mr Githongo; and did not tell him that money from graft would be used to fund vote campaigns.

Mr Githongo has not accused Mr Kibaki of direct involvement in the fraud, but alleges that he must have been aware of it. Even after many detailed briefings from Mr Githongo, Mr Kibaki said publicly that he had seen no evidence of top-level corruption. Mr Githongo resigned on January 24th 2005, while in Britain; he had received several anonymous death threats.

Last year, two senior civil servants implicated in the scandal were sacked and charged with corruption. Mr Murungaru was dropped from the cabinet after Britain and America revoked his visas; a former British high commissioner to Kenya, Sir Edward Clay, had earlier accused Mr Kibaki's government of behaving “like gluttons” and “vomiting on the shoes” of foreign donors. Mr Murungi, who has denied that ALF was in any way a scandal, was made energy minister in a cabinet reshuffle in December, by which time Mr Kibaki had already received Mr Githongo's dossier.

Though badly damaged, Mr Kibaki could perhaps salvage some respectability by removing those fingered by Mr Githongo. If not, foreign donors in Nairobi speak of “fiscal consequences”, possibly including the obstruction of loans and grants that keep the government afloat. If nothing else, Mr Kibaki and his circle will almost certainly be punished by the voters in next year's election, just as their corruption cost them dearly in the constitution referendum. If those at the top do not much mind thieving politicians, ordinary Kenyans, with homes and school fees to pay for, increasingly do.

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Benin

Voodoo still wins

Jan 26th 2006 | OUIDAH
From The Economist print edition

A controversial ancestral religion still fends off foreign ones

A WOMAN in a bright dress dances round in a tight circle, the pumping artery of a headless chicken pressed to her mouth. Nearby, another woman carries a slaughtered goat on her shoulder, sucking on its red neck as she cavorts around. Benin's national day of voodoo, earlier this month, may not be how Hollywood would have portrayed it, but it comes close. “The women are not drinking the blood,” a voodoo expert, Martine de Souza, explains. “The animals have been sacrificed to the spirits, and the women have been possessed by the spirits, who are accepting the sacrifice.”

Since 1996, voodoo has officially been a national religion of Benin, a small west African republic, where more than 60% of the people are said to believe in it. Slaves from this corner of Africa brought the religion to the New World, most notably to Haiti. Its tenets echo those of many African religions. There is a supreme god, Mahu, and a number of smaller gods or spirits, with whom humans can negotiate.

“Voodoo is everything to me, it helps me get whatever I want,” says John Togbé, a school teacher. “If I have a problem I go to the voodoo chief, who makes sacrifices for me, and afterwards my problem is resolved. For example, my wife and I couldn't have children for many years. I asked the spirits for a child, and three years later my child was born.” Voodoo believers pray and sacrifice before setting off on long trips, and at big moments in their lives.

Some historians say that voodoo's bad image in the world is because Haitian slaves used it as a form of protest; it gave them a secret place where they could foment revolt against their masters. The Béninois hate the way Hollywood portrays voodoo as a source of evil. “You people in the West think voodoo is bad,” Mrs de Souza complains. “But it can only be used for good. It's true there are powers that can be used for evil, but that's not true voodoo.”

Voodoo was once banned in Benin, as President Mathieu Kérékou, a Christian, tried to please the Russians when they were his main foreign backers. Yet voodoo believers practised in secret, and eventually the ban was lifted. Moreover, voodoo still influences imported religions such as Christianity and Islam. “The Christians go to church on Sunday,” says Na Honoun, a voodoo priestess. “But they come to see us the rest of the week.”

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High jinks in Russia

With friends like these

Jan 26th 2006 | MOSCOW
From The Economist print edition

What an alleged British spy ring and mysterious pipeline explosions on the Russian-Georgian border have in common

ONE seemed to be a throwback to the cold war; the other epitomised the new tensions (especially over energy) between Russia and its post-Soviet neighbours. But the bizarre events in Russia this week offered some joint lessons.

Many Russians have mixed feelings about Georgia, their neighbour in the south Caucasus. They like Georgia's food and wine, and remember it as a Soviet-era holiday resort; but they resent what they perceive as Georgian ingratitude—especially since Mikhail Saakashvili swept to the presidency in the “rose revolution” of 2003. The two governments' tense relations were violently strained when, in the small hours of January 22nd, the two pipelines from Russia that provided Georgia's entire gas supply (and, via Georgia, Armenia's) were blown up near the Georgian border. Later in the morning, and several hundred kilometres away, an electricity line was knocked out too.

The volatile Mr Saakashvili promptly exploded himself. There is a host of possible suspects: militant Russian nationalists thought to have bombed a Russian train last year; separatists operating both in Russia and in South Ossetia, a breakaway region of Georgia; or (say some in Moscow) the Georgian government itself. But Mr Saakashvili seemed sure of the culprit's identity: the explosions were “outrageous blackmail” by an “enemy”—ie, Russia—which was unable to behave in a civilised way. “Hysterical and bacchanalian,” said the Russian foreign ministry.

The evidence that Russia or Gazprom, the state-controlled gas giant, sabotaged its own pipelines was circumstantial: the explosions appeared co-ordinated, and they happened in places supposedly controlled by Russian security forces. Mr Saakashvili alluded to Russian threats to induce Georgia to hand control of its gas pipelines to Gazprom. (Russia's sponsorship of South

Ossetia and Abkhazia, another breakaway bit of Georgia, is a further gripe.) Just when the diplomatic tone seemed to be improving, arguments began over pipeline repairs. Nika Gilauri, Georgia's energy minister, says that his man on the scene was asked to leave, after a dispute with the Russians. Zurab Noghaideli, the prime minister, says that the aim of the blasts was to “get people on to the streets” of Tbilisi and destabilise the government.

If so, it has not worked. Power cuts have been a way of life for much of Georgia's post-Soviet existence (though there have been fewer recently). And, as Merab Pachulia, a Tbilisi pollster, says, anti-Russian sentiment has been hardening in Georgia as pro-Americanism has grown. “GasPutin”, as Tbilisi protesters have dubbed Vladimir Putin, Russia's president, is likely to be blamed more than Mr Saakashvili.

Although Mr Noghaideli says the disruption, which coincided with a cold snap, caused “very severe hardship”, Georgia cobbled together interim power supplies: a high-speed version of the energy diversification that the government was anyway undertaking after the doubling of Russian gas prices. Mr Saakashvili's game is to persuade the Europeans to see his problems with Russia as something that they should be concerned about as well—the same strategy as Ukraine's government, whose gas dispute reignited this week when Gazprom yet again accused it of pinching gas intended for other countries.

Perfidious Albion

Many Russians have mixed feelings about Britain too. They associate it with Margaret Thatcher, pea-souper fogs and David Beckham; but some resent it for offering political asylum to a rogue oligarch and a Chechen separatist. The two governments' awkward relations were tested again when, on the same day as the pipeline bombs, state-controlled Russian television aired a report accusing four British embassy staff of spying. Grainy video footage appeared to show the men fiddling with a rock in a Moscow suburb last year. According to the FSB (successor to the Soviet-era KGB), the rock had concealed within it an electronic device to send and receive information from Russian accomplices, one of whom is in custody.

The impression of an old-fashioned, east-west spat seemed to be confirmed by the subsequent news that the British Council, an education and culture agency, was under investigation in Russia for alleged financial irregularities. But, on closer inspection, the real target of the exposé may be domestic. Along with the rock story, the documentary alleged that one spy was transferring funds to Russian non-governmental organisations (NGOs). The British government was tight-lipped about the rock, but insisted that all its dealings with Russian NGOs were above-board.

Well they might. To contaminate NGO relations with spookery, says Andrei Kortunov of the New Eurasia Foundation—which received a British grant for a local media initiative and was named in the television report—would be a “very serious blunder”. Foreign-funded NGOs have been vilified by the FSB and Mr Putin, who worry that they may try to foment a revolution in Russia like Georgia's “rose” and Ukraine's “orange” ones. This paranoia crystallised in a new law, signed by Mr Putin this month, that broadens the state's powers to shut down NGOs it dislikes. (Measures in an earlier version of the bill specifically directed against foreign groups were removed in the final draft.)

The NGO aspect of the spy scandal was stressed both by Mr Putin and on television. “Control over the authorities”, the rock report concluded, “must be exerted by incorruptible people who champion the interests of their homeland and not a foreign country.” The FSB says it went public after the British denied any high jinks; but a bigger factor in the timing of the revelations may have been a speech by Mr Putin at the first full meeting of the Public Chamber, a toothless new body stuffed with loyalists that is meant to help Russians talk to their government. The spy bust

neatly juxtaposed a civil society that the Kremlin approves of with the sort it doesn't.

So what are the lessons from the pipeline and the rock? Not only that strange and usually unexplained things often happen in Russia. The authorities' use of both events has been as telling as the events themselves. And both testify to the bad relations between Mr Putin's Russia and countries that were once its friends.

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The pope's first encyclical

Whatever love means

Jan 26th 2006
From The Economist print edition

What this week's encyclical says about the pope's theology and beliefs

AN OLD story tells of a bishop who is asked for his opinion about sin. He reflects for a while and says that, in general, he is against it. This week may be remembered as the moment when Pope Benedict XVI offered his views on erotic love and, contrary to expectations, said he was broadly in favour of it.

Love—whether sexual, spiritual or something in between—was the topic of the German pontiff's first encylical since being elected, at the age of 78, last April. While denouncing the modern world's reduction of eros to “pure sex... a commodity, a mere thing to be bought and sold”, he says erotic love could be “purified” to fulfil man's highest calling.

Predictably, the 72 pages of finely crafted argument made mention of the Song of Songs, the most openly erotic section in the Hebrew scriptures. With its sensual imagery—“your navel is a rounded goblet that never lacks blended wine”—that book has often been quoted by clerics wanting to defend their faith against charges of killjoy puritanism.

But what was the songster really talking about? Since that steamy stuff was written, many a commentator has argued that the poem should be seen mainly as a metaphor for a more spiritual kind of love. The truth, suggests the pope, lies in between: those sensual images were part of a love song, perhaps composed for a wedding, but within the text there is a shift from a greedy, insecure sort of love to a self-sacrificing kind. Anyway, while the pope's reflections on the erotic grabbed most headlines, his final section—about love as a social value—was perhaps more significant.

What the pontiff makes clear is that he is still waging an ideological war (begun some 20 years ago, when he was a cardinal and doctrinal watchdog) against any theology that equates the kingdom of heaven with specific political ideas, such as socialism. “Christian charitable activity must be independent of all parties and ideologies,” the pope insists—before rejecting the Marxist idea that charity reinforces an unjust world. These days, his target is not only Marxism but the involvement of Catholic charities in government-funded welfare projects, to the point where the church and worldly politics almost blur. Religious charities and governments may co-operate, but their roles are different, he says.

Does that make the pope a “compassionate conservative”, in the mould of George Bush? “No, it's the compassionate conservatives who are borrowing ideas from him,” insists Father Robert Sirico of the Acton Institute, an American Catholic think-tank.

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Portuguese politics

A tale of two prime ministers

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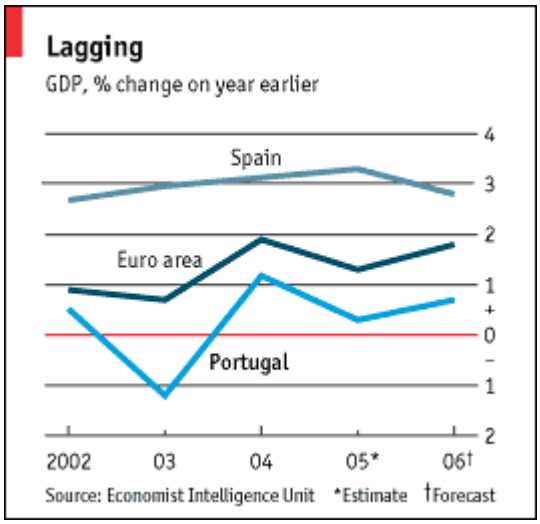
From The Economist print edition

The presidential election suggests that voters want economic reforms



FOR the first time since the return of democracy in 1974, Portugal's voters have chosen a centre-right president. Aníbal Cavaco Silva, who was prime minister from 1985 to 1995, won over half the vote on January 22nd, enough to defeat five left-wing opponents without a second round. Yet less than a year ago, José Sócrates, the current prime minister, became the first Socialist to win an overall majority in parliament for his centre-left party.

Why a switch from left to right within 12 months? The answer lies in the similarities between Mr Sócrates and Mr Cavaco Silva. Portugal's loss of competitiveness, its gaping budget deficit and its slow growth (see chart) have become familiar ills. Everybody to the right of the Communists agrees what needs to be done: trim the public sector, turn round failing schools (45% of pupils drop out before finishing secondary school) and try to encourage business investment.

Portuguese voters are not looking for new answers to these old problems. They want politicians who will do something, instead of endlessly debating them. And they hope that Mr Sócrates and Mr Cavaco Silva will be leaders prepared to risk unpopularity in the cause of reforms that have already been made in other euro-area countries, such as Finland, Ireland and, closer to home, Spain. Mr Sócrates has made a start, taking on vested interests to raise the retirement age in the public sector from 60 to 65, keep the courts open longer in the summer, and introduce English teaching in primary schools.

The most recent Portuguese prime minister to display a similar determination to get things done was Mr Cavaco Silva, whose decade in office saw Portugal embrace the market through privatisation, deregulation and investment boosted by aid from the European Union. This may explain why Mr Sócrates, despite opposing the election of Mr Cavaco Silva, is unlikely to be unduly put out by it. The two men, commented one Lisbon newspaper, are “twin souls” who should be able to cohabit easily enough.

Yet this will not spare Mr Sócrates all embarrassment over the left's resounding defeat. He chose controversially to support Mário Soares, a veteran 81-year-old Socialist, as the party's official candidate, passing over Manuel Alegre, a 70-year-old poet. A disgruntled Mr Alegre decided to run anyway, and took almost 21% of the vote, against only 14% for Mr Soares. It was not the most glorious way for Mr Soares, the man who safely guided Portugal from dictatorship to democracy in the 1970s, to bow out. But, as he said later, “you are only defeated when you give up the fight.”

Turkey and Cyprus

Island trouble

Jan 26th 2006 | ANKARA AND NICOSIA
From The Economist print edition

Rows over Cyprus bedevil Turkey's hopes of European Union membership

TURKEY this week unveiled a “fresh” initiative on Cyprus. Under the plan, the Turks would open their ports and airspace to Greek-Cypriot carriers in return for an end to the bans on direct trade that have hemmed in northern Cyprus. The European Union commissioner for enlargement, Olli Rehn, said the plan merited “careful examination”, a view echoed in Washington. But the Greek-Cypriot president, Tassos Papadopoulos, dismissed it as “an attempt by Turkey to avoid fulfilling its obligations towards Cyprus and the EU.”

Since the Greek-Cypriots said no to the UN plan to reunify the island in April 2004, they have been seen as the biggest obstacle to a settlement. After joining the EU, the Greek-Cypriots have snarled up EU proposals to ease trade restrictions on the unrecognised Turkish-Cypriot state. This week Mr Papadopoulos peevishly refused to meet Jack Straw, on the ground that the British foreign secretary had legitimised the Turkish-Cypriot state by calling on its leader, Mehmet Ali Talat, in his official office. Mr Straw hit back by praising Turkey's initiative, adding that “the current situation is bad for Cyprus, bad for the east Mediterranean and bad for the EU.”

Turkish officials never expected the Greek-Cypriots to respond positively to their plan. Rather, following soon after a decision to drop the criminal prosecution of a well-known novelist, Orhan Pamuk, they were hoping for brownie points in Brussels, which is increasingly impatient with the Greek-Cypriots. Yet Mr Papadopoulos's intransigence is widely supported by his voters. Ahead of parliamentary elections in May, opposition parties that once pressed for reunification now spout a new nationalist rhetoric.

As Mr Talat observes, many Greek-Cypriots dream of a “European solution” whereby the EU would have more say in Cyprus's future than the UN. This would mean abandoning the agreed UN formula of a “bi-zonal, bi-communal federation”—a concept that would involve both sides accepting big derogations from EU law. Instead, there would be a unitary state, with Turkish-Cypriots enjoying limited minority rights. Greek-Cypriot offers of free health care, EU passports and scholarships are widely seen as bait to coax Turkish-Cypriots into accepting this. Already, some 40,000 Turkish-Cypriots have taken Greek-Cypriot passports, and another 40,000 are waiting.

It is clear that the Greek-Cypriots see their EU membership as a way to extract concessions from Turkey. The worry in northern Cyprus is that, to keep their EU talks on track, Turkey's leaders might sacrifice the interests of Turkish-Cypriots.

The Greek-Cypriots want Turkey to fulfil its pledges to extend its customs union with the EU to include Cyprus before the end of this year. EU members known to be wary of Turkey's membership, such as Austria and France, may line up behind these demands. Should Turkey fail to open its ports and airspace to the Greek-Cypriots, its own membership talks may stall. Could

Recep Tayyip Erdogan, the Turkish prime minister, risk that?

He may have no choice. With nationalist sentiment rising, a hawkish chief of staff taking over in August and parliamentary elections due in 2007, Mr Erdogan cannot yield to the Greek-Cypriots. But disruption to Turkey's EU talks would shake investor confidence and put at risk robust recent economic growth. So what should he do? The answer, say Turkey's EU allies, is to keep up the pace of domestic reform. A first step would be to scrap articles 301 and 305 of the penal code, under which not only Mr Pamuk but many others are being prosecuted for alleged insults to the Turkish identity. As Turks point out, fixing Cyprus is not a condition for joining the EU. But respecting human rights is.

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An East German legacy

Stones of contention

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The row over what to build in place of East Germany's old parliament

IT IS easy to see why Germany's parliament has decided to tear down the Palast der Republik, a communist-era landmark in Berlin. Historically and aesthetically, the building, once home to East Germany's parliament, has all the charm of a second-world-war bunker. It is also unsurprising that an alliance of ex-communists and progressive artists hoped to keep it. With only a skeleton of steel beams left inside after asbestos had been stripped out, it has become a cool venue for parties and exhibitions.

But why have more than four years passed since a commission first recommended demolition? And why might it take another six before reconstruction begins on the site of the Berlin Schloss, the baroque residence of Prussian kings that was dynamited in 1950?

One answer is the difficulty of taking down such a huge building. It took until May 2003 to strip out the asbestos. Demolition will take another 18 months. The ground is unstable. Indeed, as one firm dismantles the structure, another will be filling the basement with a mixture of water and sand. Then there is money. Estimates for the cost of rebuilding the castle range from €670m ($820m) to €1.2 billion. Neither the federal government nor the city of Berlin has spare cash, and they cannot agree how to split the bill. A foundation set up to raise money to rebuild the baroque façade has collected only a little.

Germany's fondness for consensus also slows things down. The new building is considered the “final stone of unification”, says Wolfgang Tiefensee, the construction minister. Many people want their say. Whether, the building will ever house the planned “Humboldt Forum” (a mix of cultural and scientific institutions) is anybody's guess.

Expect more heated debate. When Mr Tiefensee, a Social Democrat from the east, suggested that the building might house a hotel and the next step should be to pick a private investor, not an architect, some critics talked darkly of a Cinderella castle and muttered about the Disneyfication of Berlin.

Visitors will not see any new building at all for many years. For now, the city plans to lay down a lawn. Only in 2018, at the earliest, might the Humboldt Forum open its doors, says Mr Tiefensee. At least unified Germany may act faster than its ex-communist part. More than 25 years elapsed between the demolition of the old Prussian pile, badly bombed in the war, and inauguration of the Palast in 1976.

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Politics in central Europe

Party games

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Troubled coalitions are now common across central Europe

COMPARED with its neighbours, Poland's political puzzle is a doddle. Two right-wing parties with overlapping views but squabbling leaders? Nothing unusual. A government dependent on support from wacky populists? Standard practice. Legislative stalemate, a delayed budget, talk of an early election? Background noise.

Yet to western Europeans it all looks baffling. Most are used to a well-defined political spectrum occupied by parties with decades of history, consistent ideologies, a strong local-government base and a mass membership. Coalitions tend to consist of a big party and a few like-minded small ones. In post-communist countries, in contrast, political parties have small memberships, personalities matter more than ideologies and the division of spoils looms large. Coalitions often include seemingly incompatible members.

Take the Czech Republic, which has three squabbling centre-right parties in parliament. Two are in the ruling coalition with the centre-left Social Democrats. The third and biggest, the Civic Democrats, are the main opposition party, alongside the unreconstructed Communists. The government, which has a one-vote majority, is neither effective nor consistent, and it is plagued by scandal. But it has managed to stick around for nearly four years, good going by the standards of the region.

Slovakia is even more remarkable. Although the government looks weak and divided, it has pushed through impressive changes since 2002. It comprises two rival Christian Democrat parties, a group representing ethnic Hungarians and a populist pro-business party. At present it commands only 68 votes in the 150-seat parliament, but it survives with the support of independents and populist deputies. Sadly, voters seem unimpressed by supply-side reforms, including a flat tax, that have delivered strong growth and won accolades abroad. They consider the prime minister, Mikulas Dzurinda, to be untrustworthy, and regard the deals he does to stay in power as sleazy.

In comparison, Poland's troubles might look modest. Last September's election produced a surprise: Law and Justice, the less brainy and more populist of the two centre-right parties, won 155 of the 460 seats in the Sejm, or lower house of parliament; its partner-cum-rival, Civic Platform, took only 133. When negotiations with Civic Platform then broke down, Law and Justice formed a minority government, dependent on support from the left-wing populists of Self Defence, the right-wing, slightly kooky, League of Polish Families, and the agrarian Peasant Party.

Central Europe's variety show

	Government's flavour	Pluses	Minuses	Likely date of next election
Bulgaria	Left/monarchist/ Turkish	Strong, EU membership close	Gangsters untamed	2009
Czech Republic	Left/centre-right	Durable	Scandals, weak	Jun 2006
Estonia	Free-market/populist	Booming economy	Inflation threatens	2007
Hungary	Centre-left/liberal	Incomes rising	Spendthrift, indebted	Apr 2006
Latvia	Pro-business	Stable, strong economy	Conflicts of interest, complacent	Oct 2006
Lithuania	Ex-communist/ populist/liberal/rural	Euro almost in reach	Scandals, slow reform, unstable	2007
Poland	Populist	Clean, tough	Squabbling, unstable	2009*
Romania	Centrist/free-market/ Hungarian	EU membership close	Scandals, in-fighting	2008
Slovakia	Free-market/populist/ Hungarian	Big reforms, strong economy	Scandals, divisions	Sep 2006
Slovenia	Centre-right/centre-left	Stable, euro in sight	Few reforms	2008

Source: *The Economist* *Or later this year

The result has been months of inaction and posturing. The party chief of Law and Justice is Jaroslaw Kaczynski, whose identical twin, Lech, won Poland's presidential election in October. Views differ on whether the twins are master-tacticians or chronic intriguers. At any rate, Law and Justice has begun to lure discontented members of Civic Platform to its side. Its biggest coup was getting Zyta Gilowska, an economist who had fallen out with Civic Platform and is now finance minister.

But the party's appetite for backstabbing and procedural tricks remains. Recently, the president produced new legal advice advancing the deadline for approval of the 2006 budget to January 30th, three weeks earlier than expected. If the upper house fails to pass it in time (the Sejm did so this week), he may call an election. Voters seem to be on the government's side, and against parties that cause it trouble. Polls suggest that Law and Justice would do well in an election, and the minority parties badly—putting them under pressure to back the government.

The Kaczynski brothers are now pushing a new stabilisation pact, which is prompting fresh efforts to lure Civic Platform into a coalition. If that works, it could give Poland a stable, reforming government for some years. But even then, few would bet on a political leadership that focused on running the country, rather than scoring political points or manoeuvring for the next election.

The gloomy conclusion from recent years is that the only sure stimulus for good government in post-communist countries is external, notably a desire to join the European Union. Bulgaria's fractious political parties have come together in the hope of winning the go-ahead this summer to join the EU in 2007. The ruling three-party coalition unites the party of ex-King Simeon, the Socialists who were once his most dogged critics, and a Turkish minority group. Neighbouring Romania, equally desperate to enter the EU in 2007, has a centre-right coalition that is making belated headway against a backward administration and endemic corruption. The government is backed by a popular president, Traian Basescu.

For countries already in the EU, some other external stimulus is needed. One could be their hopes of joining the euro. Estonia and Slovenia have well-disciplined coalition governments committed to adopting the single currency next year. But for most other countries the euro is a distant, and maybe less appealing, prospect. It would be nice if a new constraint on political parties could be the competition to deliver good government, prosperity and stability to voters. But that would

require a new public-spiritedness, which on the rubble of communism seems a long time a-growing.

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Charlemagne

Reform or die

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The chances of economic reform in Europe may be better than many believe

"LAST year saw a decisive shift in the European Union," declares the European Commission in this week's report on national plans for economic reform. "Progress towards economic reform is under way...If we can redouble our energies [these plans] will be seen as a genuine turning point towards growth and jobs."

Oh yeah? These plans are part of the so-called Lisbon strategy of 2000 that was supposed to make Europe "the most competitive and dynamic knowledge-based economy in the world" by 2010. Yet since 2000, Europe has slid farther down almost every economic league table. Why should things be any different this time? The answer is that the conditions that encourage reform in Europe may just be slotting into place.

Most countries that reform do so under a sort of corollary to Alexis de Tocqueville's dictum that "the most dangerous moment for a bad government is when it starts to reform". In economics, the best time to reform is a dangerous moment: during or after a crisis. The bad times persuade voters that change is needed. The recovery afterwards masks the short-term costs of reform and helps the benefits to come through more quickly.

This not only applies to feckless emerging countries whose currency collapses, but also to old, cold Europe. Most of the biggest recent reforms in Europe came about after crises: Britain post-1979, Ireland in the late 1980s, Finland after the collapse of the Soviet Union in 1990, Sweden after bank failures in the early 1990s. But these crises hit only individual countries. A problem for Europe as a whole is that it has not had to endure the sort of misery that makes reform preferable to doing nothing.

Now, however, there is a chance that the “bad-times-can-be-good-times” rule might start to apply more widely. Not because continental Europe is about to endure a wrenching recession; in fact, the euro-area economies, led by Germany, are picking up. It is rather because, after a long period of slow or no growth, the spreading sense of malaise is at last creating an appetite for change. If this is followed by modest economic success, that may make changes more palatable as well.

Growth in the euro area will be about 2% this year. That is hardly high, but it comes after years in which Europe has fallen farther behind America in incomes per head and productivity. Now, the gap may no longer be widening—and may even be closing a little. Job creation in the euro area has been better than many realise over the past decade. In short, after a long run of failure, Europe may this year have less to be ashamed of.

There is also a broad policy consensus. National Lisbon programmes vary, of course. Some are feeble on services (Germany's barely refers to them). But all are trying something, however modest, whether it be tax incentives for R&D (France, Spain, the Netherlands and Hungary) or pension reform (France, Italy, Spain, Austria, Portugal, Belgium and Finland). Europe's problem, indeed, is not the absence of any change; it is that change has been patchy and inconsistent.

Some centrally co-ordinated idea-swapping might help, not least by increasing competition in good policies. There is a case for Europe-wide policies in a few areas, like energy. And in the euro-area countries, policy co-ordination can partly deal with the problem that, if only one country reforms, some benefits may go to its neighbours. A recent study by the IMF argued that, if France implemented the structural reforms it has promised, this would raise its national income by around 10% (compared with doing nothing). But if everybody in the euro area did the same, French incomes would rise by 14%.

In any case, policy differences have never been the main obstacle to change in Europe. As Jean-Claude Juncker, the prime minister of Luxembourg, once put it, “we all know what to do. We just don't know how to be re-elected once we've done it.” On the whole, vested interests opposed to change—trade unions against labour reforms, entrenched companies against tougher competition law—are better organised than those in favour.

Dud politicians

It has to be admitted that, for the next year or so, politics in the three biggest euro members hardly looks propitious. In what is surely his last year in office, President Jacques Chirac of France is unlikely to risk anything that might blow up in his face (again). In Italy, which goes to the polls in April, neither the centre-right government nor the centre-left opposition look like eager reformers. And in Germany, the grand coalition is devoting its energies to sorting out the public finances, not to making more reforms to labour or product markets.

The good news is that there is growing public acceptance of reform. The opinion polls are clear: slow growth has persuaded people that change is desirable and perhaps inevitable. The European paradox is that everyone knows that more reform will come, and many think it might even work, as it has in Scandinavian countries. But they still do not vote for it. Their attitude is like St Augustine's: “Lord, make me chaste, but not yet.”

At some point, this will surely change. Indeed, it may already be changing in Germany. German consumer confidence, and with it the economy, has started to bounce back. It seems reasonable to infer that something similar might happen throughout Europe as growth picks up, and that, if it does, this might make another round of reform palatable.

Given the politics in the big three, given the modest scope of changes under discussion and given

that the past few years have been ones of disappointment rather than full-blown crisis, the most likely outcome would be only mild reforms. The big question is whether that would be enough (the commission says Europe is 50 years behind America on innovation, for example). But that is for the future. For now, even mild reform would be better than nothing.

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Fighter jets

Keeping secrets

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Signs of Anglo-American strain in the world's biggest defence contract

AS MILITARY jets go, few are as ambitious as America's $256 billion (£144 billion) Joint Strike Fighter (JSF). Not only is it the largest defence contract ever signed, but it has grandiose political ambitions to boot.

Rudy de Leon, America's former deputy defence secretary, was so taken with the moment in 2001 when Britain committed $2 billion to help develop the jet that he evoked the memory of Winston Churchill. “Today we once again fulfil his optimism for our two nations and find as constant as the sun our partnerships,” he declared.

Clouds have since appeared. Last week, Tony Blair reportedly contacted the White House for the third time in almost as many weeks to lobby against the cancellation of a $2.4 billion contract awarded to a British firm, Rolls-Royce, along with America's General Electric, to develop a second engine for the fighter. Underlying British disappointment over that contract, awarded only last August, is a deeper resentment over access to key technologies on the jet.

The fighter jet, which comes in different versions that can take off and land on anything from paved runways to aircraft carriers, is being designed and built by nine countries, with Britain as the only “Tier I” partner. The project was originally supposed to cement a transatlantic alliance forged in opposition to the Warsaw Pact. But that enemy is no more, and the rapid evolution in weapons technology has further strained the alliance.

Earlier fighter planes, such as the widely used F-16, were simpler to build and maintain. Today Britain and America are moving towards a style of warfare that sees fighters, tanks and ships not as individual weapons but as components in a vast network able to share information and pass targets from one to the other. In this “network-centric” way of fighting, software and data-handling move to the fore while steel armour and heavy engineering take a back seat

Britain wants access to the software and systems used on the JSF so that it can add weapons and upgrade the fighter independently over the next 30 years. It needs to understand the data flowing to and from the plane to integrate it into bigger networks of weapons. Defence chiefs worry that without such access Britain will have to call American contractors each time they want to change something.

But British pleas are falling on increasingly deaf ears in America. Since 2000, the two countries have been talking about giving Britain a waiver from arms-trade regulations that require it to apply for a licence whenever it wants to buy American military equipment. While the White House and State Department have supported a waiver, Congress has repeatedly blocked it. The House Committee on International Relations warned in 2004 that exempting Britain from the International Traffic in Arms Control Regulations (ITAR) would increase the risk of sophisticated

weapons, perhaps indirectly, being passed to terrorists or unfriendly nations. British companies dispute this, pointing out that many of them now do more than half their business in America and are unlikely to do anything to jeopardise their position in the world's largest arms market.

Underpinning British resentment over America's secrecy on the JSF is a sense that the special relationship between the two countries that dates back to the second world war has been betrayed. America and Britain routinely share intelligence and have a long history of defence co-operation. Britain's nuclear deterrent rests on submarine-launched ballistic missiles that are leased from America but equipped with British warheads. Britain contributed some 46,000 troops to the American-led coalition that occupied Iraq in May 2003, making it the largest non-American force in the coalition; it is about to send 4,000 more to Afghanistan.

“We fought shoulder to shoulder alongside them,” says Sir Digby Jones, the director-general of the Confederation of British Industry, a trade body, who has lobbied against cutting the JSF's second engine. “This is no way to treat your best friends.”

At the moment, British companies are still able to get most of the technology they need to keep working on the JSF by applying for a succession of licences covering each bit as they go. The Ministry of Defence says talks are under way to secure access to technology during the life of the aircraft, before Britain agrees to buy any of the 150 jets, at $104m apiece, it has said it wants. But now it is also looking at alternatives to the aircraft, amid concern that it won't get the technology.

That may mean looking to Europe. Alternatives to the JSF include the French Rafale jet, which comes in a version that lands on aircraft carriers, or an adapted version of the Eurofighter Typhoon, a jet being built by Britain, Germany, Spain and Italy. Other projects could be attractive too. This week, France teamed up with Britain on new aircraft carriers, offering to pay about a third of the design costs.

“2006 will be the critical year for developing the future of the JSF programme in Britain,” says Nigel Whitehead, the managing director of air systems at BAE Systems, Britain's biggest defence contractor.

Despite the hard feelings, Britain seems unlikely to quit the JSF, not least because it stands to profit handsomely from its sales to other countries. And withdrawing would also harm future collaboration on other defence projects such as Britain's Future Rapid Effect System and America's Future Combat Systems (FCS). Both are projects to develop a high-tech family of armoured troop-carriers. With America likely to spend about $30 billion just on researching and developing the FCS (and as much as $120 billion more buying it), the logic of sharing some of the costs is unassailable. But until the current dispute is resolved, expect to see Britain steering well clear of new arms partnerships with its closest friend.

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Nuclear power

Technology transfer

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Selling Westinghouse is lucrative but controversial

Get article background

GOVERNMENTS—especially Britain's—are not known for being canny investors (see article). But the purchase and sale of Westinghouse, an American builder of nuclear reactors, by state-owned British Nuclear Fuels (BNFL) may prove a lucky exception. BNFL bought Westinghouse in 1999 as a prelude to possible privatisation. As BNFL's troubles mounted, however, the prospect of a float receded. When it said in July 2005 that it planned to sell Westinghouse, the response was instant. Fifteen bidders sprang into action, quickly whittled down to four.

On January 24th BNFL announced Toshiba, a huge Japanese power-to-electronics conglomerate, as its preferred bidder—meaning that it had all but won the contest. No price had been confirmed as *The Economist* went to press but a figure of $5 billion (£2.8 billion) was widely rumoured—more than twice the original prediction and over four times the $1.2 billion that BNFL paid for it.

That's because the nuclear industry is in its most optimistic mood for years. Worries over climate change, energy security and high fossil fuel prices have encouraged several countries to consider (re)investing in nuclear power. George Bush has called for new reactors in America. China is committed to building dozens of new plants by 2020, and several European countries are flirting with the idea as well. Indeed, the British government launched the consultation phase of its energy review—which many think is designed to prepare the ground for a new set of nuclear plants—on the same day that news broke of the Westinghouse deal. The International Energy Agency reckons that around $200 billion will be spent on new nuclear power stations over the next 25 years.

If the deal goes through, it will give Toshiba a chance to capture a big slice of that spending. Westinghouse has designed half the world's existing reactors, and it is already active in China. Officials there have decided to build pressurised-water reactors—a technology that Westinghouse specialises in—rather than the boiling-water designs offered by Toshiba.

Such rosy prognostications have caused critics to question the government's decision to sell just as nuclear power looks set for a renaissance. They argue that there is more money to be made by hanging on to Westinghouse than by selling it. Some detect the influence of the Treasury, pointing out that a sale would improve the rather sickly public finances. And there are worries about the implications for any new British reactors.

Ian Fells, an energy consultant, thinks that, without Westinghouse, Britain may find its nuclear ambitions thwarted: “If and when we decide to go down the nuclear route there will be a queue at the nuclear power-station builders. If that queue is to be jumped our best chance is owning Westinghouse, not selling it,” he says.

The government defends its decision on the grounds that, if it does decide to build more power plants, owning a major reactor-builder could lead to competition problems. And it argues that Westinghouse's Asian ambitions are unacceptably risky for a company owned by taxpayers. Malcolm Grimston, a nuclear expert at Chatham House, a think-tank, points out that any Westinghouse-owning government would be on dodgy ground if it decided it wanted new nuclear stations in Britain: “If Westinghouse won the bidding, people would suspect it had been fiddled,” he says. “But if they didn't, it would imply that the British government had no confidence in its own technology.”

Another reason may simply be that the government has looked at the evidence and drawn a logical conclusion. Its record on running civilian nuclear power projects is one of constant delays and huge cost overruns. Better, surely, to sell its assets to more capable managers and pocket the cash, buying future services as needed.

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QinetiQ

The boffins go public

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Labour's first real privatisation is less suspicious than it sounds

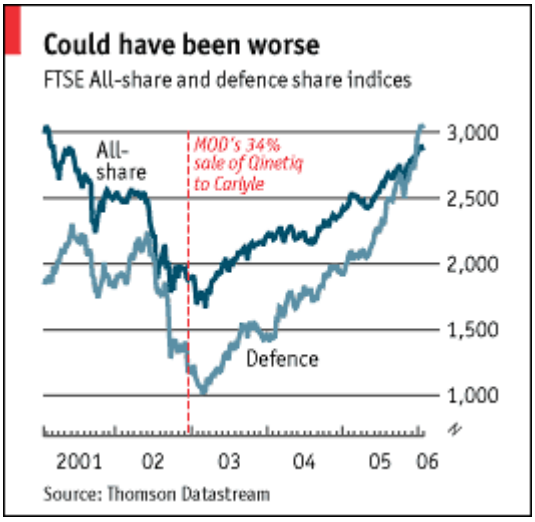
COUNTRIES seldom float parts of their defence ministries on the stockmarket. The sale of the oddly named QinetiQ, which was once part of the government's Defence Evaluation and Research Agency (DERA), has therefore caught the eye of people who never normally follow the fortunes of a medium-sized private equity deal.

QinetiQ may also be Labour's first real privatisation. The government has so far preferred to bring private money and nous to things it owns through Private Finance Initiatives and Public Private Partnerships, thus avoiding headlines about fat cats and windfall profits that damaged the last Tory administration.

The chances of this sale passing quietly are slim, though. On January 25th the company announced the price range for its initial public offering (IPO) of stock, valuing the firm at between £1.1 billion ($2 billion) and £1.3 billion. But only in 2002, looking for capital and managerial vim to help DERA make the most of itself internationally, the government sold a 34% stake in the business to the Carlyle Group, an American private equity firm, for just £42.2m. The price at which the whole firm will now be floated will earn Carlyle around eight times its money.

Carlyle is understandably pleased; others reckon the original price was a steal. On January 26th, the National Audit Office launched an investigation into the deal. Did Carlyle run some especial risk, or bring unique skills, to justify that return? Because the Ministry of Defence is QinetiQ's biggest shareholder and biggest customer by some way, the venture was less risky than many. And Sir John Chisholm, who ran DERA, carried on happily as QinetiQ's boss.

Yet Carlyle bought its stake in an auction, against some 40 initial bidders. The ministry says it offered the highest price. So the strongest criticism that can be made is that the government was guilty of lousy timing, selling when the market was depressed and QinetiQ was undervalued (see chart). At least it was smart enough to hitch itself to some canny operators: as majority shareholder, the government too will make a packet.



A second reason why QinetiQ might have been undervalued is that it is a rather odd company. It employs large numbers of scientists, owns lots of intellectual property and is good at coming up with saleable gadgets such as liquid crystal screens. But no one knew what this wisdom was worth. David Parker, of Cranfield Business School, argues that bits of government

are always hard to value, since they tend not to resemble any companies operating in the market.

Both QinetiQ and Carlyle maintain that the increase in the business's value is entirely down to the way it has been transformed in the past few years. Doug Webb, QinetiQ's chief financial officer, points to acquisitions in America, giving QinetiQ's core defence business access to a far bigger market, and to increases in operating efficiency. But why did it take private equity to bring these changes about? Lord Drayson, the minister for defence procurement, has a simple answer: “M&A is not something you get much experience of in the civil service.”

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Education reform

Danger: good schools ahead

Jan 26th 2006
From The Economist print edition

The row about admissions reveals real disagreement over the future of schools

GORDON BROWN, the chancellor of the exchequer, calls fairness one of his country's core values. He used the word and its variants 29 times in a short speech recently on what it means to be British.

Whether or not Mr Brown is right about the country, he is certainly on to something as far as his own Labour Party is concerned. Proposed reforms to give secondary schools more freedom to run their own affairs have provoked formerly loyal MPs into jeremiads about the direction in which their party is going. The new system would make it possible for unscrupulous middle-class parents to steal school places that belong to the deserving poor, they say. It's unfair—and not what Labour is supposed to be about. A bill based on a white paper published in October is expected next month, and it is in trouble.

The backbench rebels are rallying round a 73-page document not previously much in the public eye: the School Admissions Code of Practice. This sets out a list of principles that an "admission authority" (either a school itself or its local education authority, depending on the school's legal status) must "have regard to" when deciding which children it will accept if it gets lots of applications. According to the code, it is "fair" to give preference to those who live nearest the school or in a particular catchment area, or have siblings at the school, or attend a designated "feeder" primary school, or who practise a particular religion. Selecting by academic ability is not only "unfair", but illegal, except at grammar schools that have been open since before 1998.

Different schools can, and do, give priority to different criteria. This means that some children can fall between the gaps and fail to get into any popular school. Other children, meanwhile, will satisfy many schools' criteria and be able to pick and choose. According to a recent survey by *Which?*, a consumer group, finding a school place for your child is as stressful as moving house or divorcing

The white paper, in fact, says little of substance about admissions. But with the question of who gets into which school already so fraught, the rebels command attention when they say that the proposed reforms will increase social segregation and reintroduce academic selection by the back door. But their proposed solution—to make the Admissions Code of Practice legally binding—is as wide of the mark as is their perception of the problem. The code is already widely obeyed and the education secretary, Ruth Kelly, has explicitly ruled out any new selection by ability.

But judging by the apocalyptic language, the rebels think something big is at stake. On January 19th, Lord Kinnock, a former Labour leader, gave a warning that the planned reforms would lead to a "dreadful shattering of the school system". And an "alternative white paper", published in December 2005 and signed by 91 Labour MPs—more than enough to scupper the reforms, unless the Tories back them—warned darkly of "undesirable and unpredictable consequences".

The truth is that admissions are just a proxy in this battle. The real issue is a fundamental disagreement over how to go about improving schools.

Those who set themselves against the reforms admit of only two ways to make schools better: to insist that every school take a representative mix of children of different backgrounds and abilities, or to make all children go to their local schools, with extra money for schools in poor areas. A “failing school” is just one with too little money spent on it or not enough middle-class children forced to go there.

The white paper sets out a rather different approach to school improvement. It will become easier to open new schools and expand existing popular ones, and if a school is unpopular it will have no right to stay open. With the abolition of the school organisation committees, current suppliers will lose their veto over the entry of new ones, and charitable “trusts” will bring outsiders with new ideas into the world of education.

The rebels clearly don't trust parents to judge what is best for their children. A recently published pamphlet that has attracted much praise from them condemns all school choice on the grounds that “those with the confidence, resources and connections always make the best choices”. In contrast, at his monthly press conference on January 23rd, Mr Blair said that he always spoke on education “as a parent first”. A government should give people the power to help themselves, rather than tell them what is best for them. And that really is fair.

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Northern Ireland

Old wounds

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From The Economist print edition

Northern Ireland's very own Truth and Reconciliation Commission

POLITICAL progress in Northern Ireland is often thwarted by bitter memories. As Tony Blair and Bertie Ahern made another push this week to restore Belfast's devolved assembly, an effort to drain one reservoir of mistrust also got under way. At issue is the belief that police have deliberately left uninvestigated some of the many murders in the history of the Troubles.

The grandly named “Historical Enquiries Team” (HET) has £31m and six years to re-investigate killings for which prosecutions might still be possible. Made up of Northern Irish police and detectives from other forces, and headed by two officers from London's Metropolitan Police, it is to rake over 3,268 “unnatural” deaths that took place during the past 30 years.

Few doubt that forensic advances—DNA testing in particular—could bring new convictions for long-ago killings. Yet scepticism surrounds the plan. Some of the original investigators are dead; many are retired. And the HET has no powers to compel anybody to answer questions.

Retribution will be anything but terrible, as a person convicted of a "terrorist-type crime" committed before the Good Friday agreement in 1998 serves no more than two years in prison. The HET's chief goal is to bring “resolution” to the families of the dead, by answering as many questions as possible.

Whether the families will want the new outfit's help is another question. The team insists that it is independent of the Northern Ireland Police Service and the government, but the legacy of the Troubles means it will be hard to maintain a reputation for even-handedness.

The team will have to win over men like Jim Dixon, a 69-year-old Protestant who was injured in the bombing at the Enniskillen Cenotaph on Remembrance Sunday, 1987, when 11 people died. Nobody has been prosecuted, though unionists have repeatedly named an alleged suspect in Parliament. “There was no investigation done, just the appearance of it,” says Mr Dixon. He attributes the lack of progress to a wish to protect senior republicans.

Catholics have suspicions of their own. Pat Finucane, a Catholic lawyer, was shot dead in front of his family in 1989. An investigation headed by Sir John Stevens, a former Metropolitan Police boss, found that his death involved collusion between security forces and loyalists. The Finucane family is rejecting a proposed wider inquiry under regulations—rushed through Parliament last year—which would allow ministers to withhold information. “The truth of what happened and why is located in the secret corridors of Whitehall,” says the family. It will not be welcoming the HET men, either.

Against this bleak backdrop, the team is unlikely to repeat the success of South Africa's Truth and Reconciliation Commission. The point is, they are trying.

Public finances

After the binge

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From The Economist print edition

The crash diet will be hard to bear

GORDON BROWN prides himself on his new regime for public spending. Before he became chancellor of the exchequer in 1997, departments got their budgets every year. Now almost three-fifths of expenditure is allocated up to three years ahead. Mr Brown believes that this makes for better spending, not least by ending wasteful end-of-year splurges.

Yet the actual pattern of spending under Mr Brown's watch looks less enlightened and more like fiscal bulimia. In Labour's first two years, real spending fell by an average 0.2% a year. In the following seven years to 2005-06, it leapt ahead at a rate of 4.8%. Now a crash diet looms.

Mr Brown's largesse has forced him not just to put up taxes but to borrow a lot. On January 24th, the chancellor got a ticking off from European finance ministers for running an "excessive" deficit. They told him to cut it by £6 billion in the next financial year, which starts in April.

Mr Brown will bin that advice. He has already set out the way he will tackle the deficit. In his pre-budget report in December, the chancellor raised annual taxes by £3 billion. More important, he set out plans for future spending cuts worth £8.5 billion a year in today's money.

That will make the next spending review in 2007, to set departmental budgets for the years 2008-09 to 2010-11, the most financially fraught in Labour's period in office. In the three years to 2010-11, spending will increase by only 1.8% a year—below the expected 2.4% rate of economic growth (see chart).

The review will involve tough choices, says the Institute for Fiscal Studies, a think-tank, in its own regular pre-budget report. Over the past seven years, health and education have been particularly favoured, with average increases of 7.6% and 6.9%. If their budgets were to grow instead by 4.4% and 2.4%, respectively, in the three years to 2010-11—and the government keeps its manifesto commitment to raise overseas aid—that would leave room for all other expenditure to grow by only 0.8%.

That other spending takes in the politically sensitive social-security budget, however. Including tax credits, this has risen in the past seven years at an annual rate of 3.5% as Mr Brown has tried to reduce pensioner and child poverty. The IFS calculates that if this budget were to rise by 2.2% in the three years to 2010-11, then all remaining expenditure—two-fifths of the total—would have to

fall by 0.1% a year. That spells a lot of pain as vital services like transport, defence and policing scrabble for their share of a shrinking pie.

The Treasury is now contemplating annual increases of only 3% for the NHS after spring 2008. While this would help other departments, they would still feel the pinch. According to the IFS, there would only be room for spending other than health, education, aid and social security to grow by 0.6% a year from spring 2008.

What's more, such a low increase for health could cause big problems for the NHS, which is failing to make ends meet despite being so lavishly funded. On January 25th, the same day the IFS presented its forecasts, the government outlined new steps to deal with 18 NHS trusts in the most difficulty because of deficits. Patricia Hewitt, the health secretary, announced that “turnaround directors” would be appointed to sort out the mess. In some parts of the country, she said, services would have to be reconfigured to cut costs.

Ominously, three out of four chief executives in trusts with deficits think that redesigning and closing services will be necessary to balance the books, according to a poll released on January 25th by the NHS Confederation, which represents health-service organisations. Such talk of cuts augurs ill for the lean years that lie ahead—not just for the health service but even more so for other public spending.

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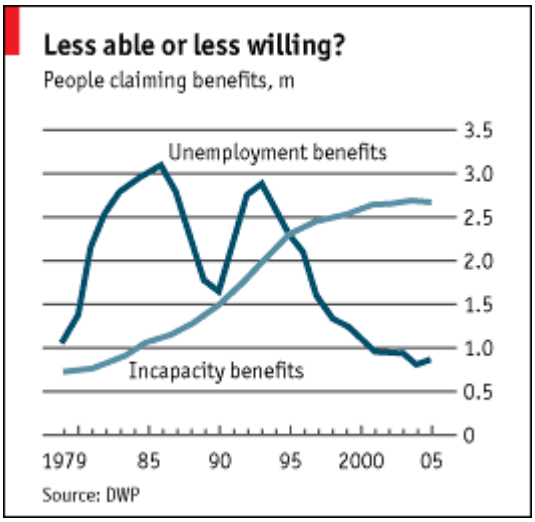
Incapacity benefits

Better late than never

Jan 26th 2006
From The Economist print edition

Not before time, Labour has a plan



WHEN Tony Blair swept into office in 1997, he promised to enact far-reaching welfare reform. Nine years later, his government has finally got round to tackling the bit of the system where a shake-up is most urgent.

Around 2.7m people—7% of the working-age population—currently receive incapacity benefits. Over the past nine years, the number has risen even though unemployment has fallen sharply and employment has increased by 2.3m (see chart). Some claimants are genuinely unable to work at all. But most are economic and social casualties, who are taking advantage of the fact that benefits for incapacity are higher than unemployment claims.

The stereotypical claimant is an older man in Britain's former industrial heartlands who has lost his job. But the prosperous and more populous south-east now has more claimants than the poorer north-east. Over half of claimants are under 50 and two-fifths are women.

Not before time, Mr Blair's government has drawn up a plan to deal with the mess. Characteristically, it dresses up its proposals as being soft-hearted rather than hard-headed since the political priority is to win the support of Labour backbenchers. The reform is billed as “the right to enter the world of work”. For those less finely tuned to the nuances of New Labour-speak, that translates roughly as a mix of carrots and sticks to get the work-shy off benefits.

Once people get on incapacity benefits they tend to stay there. Of the total number of claimants, around 60% have been receiving help for four or more years, and 35% for eight or more years. The main thrust of the reforms is to try to restrict the flow of new claimants and to exert pressure early on for them to get back to work.

A first step is thus to alter the procedures for awarding the benefit. Instead of testing whether people qualify for incapacity benefit, the approach will be to see what work they are capable of doing. Second, the benefit—to be renamed the employment and support allowance—will be paid at a flat rate. Currently the benefit gets more generous after six months and a year, which encourages people to become long-term claimants. Third, there will be concerted, regular efforts to get people back into work, with financial sanctions for those who fail to meet conditions such as attending work-focused interviews.

Existing claimants will be allowed to retain their existing benefit. But the aim is to increase pressure on them, too, to return to work. Altogether, the government thinks it can cut the total number of claimants by a million over a decade with an eventual saving of up to £7 billion a year.

That prize is worth the effort. The pity is that the Labour government has taken so long to make it. The delays will continue. Although pilot schemes will be extended to a third of the country by the end of this year, the main reform will come into effect only in 2008.

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Medical marijuana

Second best

Jan 26th 2006
From The Economist print edition

Cannabis moves from the streets to the medicine cabinet

BRITAIN'S 1.8m regular dope smokers could be forgiven for being even more confused than usual on January 19th. No sooner had Charles Clarke, the home secretary, stressed the dangers of cannabis (though he has no plans to reclassify it so that possession would attract stronger penalties) than, across town, a company legally growing the stuff told investors that business was booming. GW Pharmaceuticals probably enjoyed the irony. Official hostility to smoking dope is good for business if you're the world's only producer of pharmaceutical-grade cannabis extracts.

GW was licensed in Britain in 1998 partly because of official antipathy to people smoking cannabis for relief from the symptoms of multiple sclerosis, AIDS and cancer. “The nightmare of the time was wheelchair-bound multiple sclerosis patients being wheeled down Whitehall in protest,” says Geoffrey Guy, GW's founder. When even the ancients in the House of Lords suggested that doctors ought to be able to prescribe cannabis, a compromise was inevitable.

Sativex, an under-the-tongue spray developed by GW, promised to help both patients and politicians. A regulated, prescription-only product that couldn't possibly be confused with recreational marijuana would allow the government to placate patients without legalising general consumption. Clinical trials started in 1999 and are continuing. Meanwhile GW is attracting interest abroad. It sold C$1.1m (£500,000) of the drug in Canada last year. And the Spanish government has contracted GW to supply Sativex to 600 patients.

The best prospects lie in America, where this month the Food and Drug Administration (FDA) gave its blessing to clinical trials of GW's cannabis-based pain-killer on patients with advanced cancer. Twelve states let people use medical marijuana, and as many as 115,000 people may have been prescribed it. But federal officials have threatened to arrest even those users licensed by their states.

Sativex, which comes closer to an extract of the whole weed than currently approved drugs, might be expected to please everyone. But proponents of medical marijuana are ambivalent. Some argue that Sativex is pricier and less effective than an ordinary joint.

“Sativex's saleability depends on people and governments believing marijuana is very dangerous, and only they can eliminate the dangers,” says Lester Grinspoon, a professor of psychiatry at Harvard Medical School. “The bottom line is that that Sativex isn't as good as whole smoked or vaporised herbal marijuana, which is remarkably non-toxic for something so useful as a medicine.”

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Bagehot

Is this the strange death of New Labour?

Jan 26th 2006
From The Economist print edition

The opposition to Tony Blair's school reforms shows the fragility of his legacy

Get article background

WHAT is it about Tony Blair's school reforms that has made them, in the minds of both the prime minister and those who oppose them, a crucible for the very idea of New Labour?

At face value, next month's education bill will be not much more than a cautious evolution of some moderately promising existing policies (see article). Yet to hear some of Mr Blair's critics one would think he was plotting the greatest act of political vandalism since the dissolution of the monasteries.

Lord Kinnock, a former leader who up till now has been scrupulously loyal to his successors, last week condemned the plans as “at best a distraction and at worst dangerous”. More than 90 Labour MPs have signed up to a so-called “alternative white paper”. Few of them include the “usual suspects”, habitual rebels who can always be relied upon to cause trouble.

As things stand, getting on for half of all backbench Labour MPs appear hostile to the forthcoming bill that Mr Blair described this week as “fundamental to the government, because it is about everything to do with the politics of the government—what we think, how we feel, what is our basic position.”

But what Mr Blair thinks and feels is different from what many in his party think and feel. Schools

have long been a sacrosanct issue for Labour. A generation ago, the abolition of selection in nearly all state schools and the establishment of comprehensives that children of all abilities and from all backgrounds would attend were the party's greatest cause. It is still seen by Labour activists as one of the party's proudest and most lasting achievements, along with the founding of the NHS.

The neighbourhood comprehensive school was not just the guarantor of a fair allocation of educational resources and opportunities, but the bedrock of a more egalitarian society. That sense of idealism survives despite the depressing reality of too many schools that let down pupils because of low aspirations and poor teaching—defects that the faithful explain away as the result of inadequate funding and the failure to exorcise private education and the few remaining grammar schools.

In the early days of New Labour, the mantra was “standards not structures”. New Labour pressed for nothing more radical than a return to more traditional teaching methods and echoed parents' concerns about school discipline. Thanks to a strong economy, lots of money was shovelled into teachers' pay and revamping decaying school buildings.

If Mr Blair had wanted a quiet life, that's where he would have left it. To his credit, he has refused to be satisfied with a system that leaves more than half of school-leavers with indifferent qualifications. But his realisation that the only way to drive up standards is through allowing schools to develop a strong, individual sense of purpose and ethos, galvanised by good leadership and the drive of external partners, causes grave offence. It not only confronts the professional complacency of the educational establishment but, more dangerously, it challenges the cherished myth of the uniformly adequate local school.

At the root of Mr Blair's argument with his party is his belief that trade-offs between diversity and equity are not inevitable. Mr Blair sees this as a tussle between New Labour wanting to level up and old Labour always trying to level down; between New Labour putting power in people's hands to do the things they want and old Labour telling people what they should want. Unfortunately, even with the determined support of Gordon Brown, it's far from clear that this is a fight he can win.

That's because the numerous opponents of the education white paper refuse to see the debate in those terms. They may be deluding themselves, but some of them genuinely think that they are the real upholders of New Labour and Mr Blair is the wrecker set upon destroying the consensus it is based on.

Part of the trouble stems from New Labour's lack of defined philosophical underpinnings. For many Labour MPs it still means little more than wearing sharp suits and being on-message about “modernisation” and “reform”. For Mr Blair, it once meant never allowing the Conservatives to make potentially fertile political territory their own, and doing what works. It still does. But, in the eyes of his suspicious MPs, that approach has gradually changed into adopting what look like Tory means, albeit to achieve what he claims are Labour ends.

The rebellion habit

The failure to develop a shared belief system has been causing Mr Blair trouble ever since the 2001 election. Electoral success (or, more accurately, Tory electoral failure) made Labour MPs less inclined to go along with every new idea Mr Blair came up with, particularly those that looked as if they had been dusted off from the shelves of some right-wing think-tank.

As Philip Cowley of Nottingham University has noted, after 2001, Labour MPs rebelled more frequently and in greater numbers than the MPs of any party since 1945. While his MPs were

beginning to think the whole New Labour thing had gone far enough, Mr Blair was becoming radicalised in his search for ways to ginger up poorly performing public services. The extent of the disaffection was partially concealed by the brute size of his majority. That is no longer possible.

Nor, sadly for his legacy, can Mr Blair invest much hope in the new intake of Labour MPs. During her long premiership, Margaret Thatcher spawned lots of little Thatcherites. But Mr Blair has failed to give birth to a new generation of Blairite MPs. Indeed, before the last election, the surest way not to get selected as a Labour candidate was to sing Mr Blair's praises.

It is of some comfort for Mr Blair that Mr Brown this week dedicated himself anew to carrying forward the New Labour torch. By the time Mr Blair leaves office, however, it may be flickering very weakly indeed.

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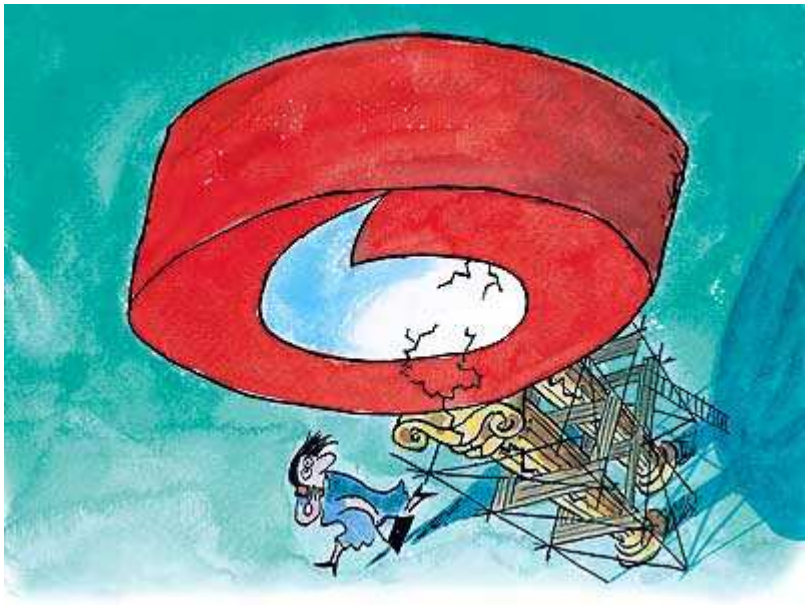
Vodafone

Calling for a rethink

Jan 26th 2006
From The Economist print edition



The world's biggest mobile operator hints at tweaks to its strategy

IS IT time for Vodafone, the world's biggest mobile operator, to overhaul its strategy? The idea is not new, but it has recently become the subject of much debate. Sir John Bond, a banker who will take over as Vodafone's chairman in July, has been doing the rounds of institutional shareholders, many of whom have expressed disquiet about the giant firm's direction. Since 2004, Vodafone's share price has underperformed the FTSE 100, London's leading stockmarket index, in marked contrast to the shares of O2, a far smaller mobile operator that has just been taken over by Telefónica of Spain (see chart).

Some investors have called for Vodafone to sell its 45% stake in Verizon Wireless, a big American mobile operator, which is worth around £25 billion ($45 billion); there are also concerns about continuing problems at the firm's Japanese unit. Yet the company has ploughed ahead with further geographical expansion, making a series of acquisitions during 2005, culminating in the £2.6 billion purchase of Telsim, a Turkish mobile operator. Vodafone has continued to pursue its unique approach of being a mobile-only operator with unrivalled global scale. But both pillars of this once-visionary strategy are now being called into question.

“Vodafone has consistently overpromised and underdelivered on its ‘bigger is better’ strategy,” complains John Karidis, an analyst at Man Securities. Vodafone has long insisted that its size provides huge economies of scale when buying handsets, network equipment and software. But while nearly all of Vodafone's regional operations use the same technology, called GSM, there are

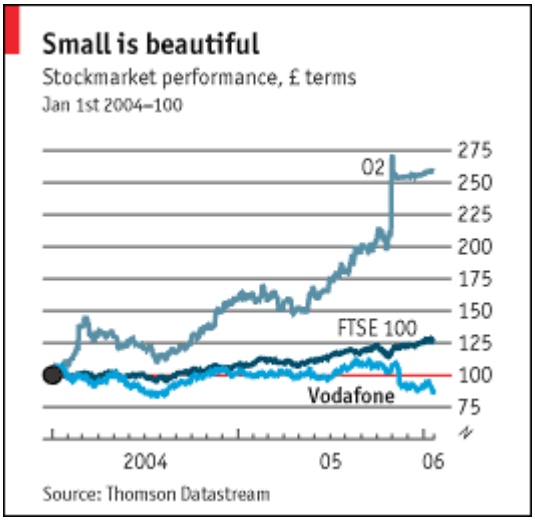
two big exceptions: its American and Japanese units.

Verizon Wireless uses a different, incompatible wireless technology called CDMA, so there is little scope for economies of scale. Nor can Vodafone, as the minority partner, exploit its brand in America. And Vodafone's attempt to use the same handsets worldwide was a spectacular failure in Japan, a unique market that is two or three years ahead of Europe in its adoption of mobile technology. Only when Vodafone relented and launched a new range of Japan-specific handsets was it able to halt an exodus of subscribers. In the process, it undermined its own argument about economies of scale. And with three new operators due to launch services later this year, the Japanese market is about to become far more competitive.

As a result, it could make sense for Vodafone to scale back its global ambitions. “The market has lost confidence in the group's ability to deliver value by pursuing their current global strategy,” David Cumming, head of UK equities at Standard Life, a big institutional investor in Vodafone, said this week. Mr Karidis says he would like to see a reversal of the expansionist strategy and more focus on execution. The company's latest trading update, released this week, was a mixed bag, with higher-than-expected subscriber growth, but declines in average revenue per user, a widely used industry measure, in Britain, Germany, Italy and Japan. The stronger performance of O2 says Mr Karidis, shows that scale is less important than “razor-sharp operating focus”.

The second pillar of Vodafone's strategy, its mobile-only approach, also looks wobbly. Around the world, telecoms operators are starting to integrate their fixed and mobile networks, offering special deals to customers who buy both services together. Beyond that, many operators are also gearing up to offer “quadruple play” bundles of fixed and mobile telephony, broadband and television services. If such “converged” bundles prove popular, Vodafone's mobile-only strategy will leave it isolated. Its voice revenues could also be undermined as cheap voice-over-internet technologies, such as Skype, spread from fixed to mobile networks. “Vodafone continues to reiterate its ‘mobile-only’ strategy when internet standards are rapidly blurring any distinction between fixed and mobile pipes,” says Cyrus Mewawalla, an analyst at Westhall Capital, a stockbroker. “Vodafone management has no strategy for convergence.”

Needless to say, Arun Sarin, Vodafone's chief executive, disagrees with the critics. “There is an advantage to scale,” he insists, “and we are happy with occupying the mobility space.” But he is also, he admits, prepared to be “flexible and pragmatic” about Vodafone's strategy. Indeed, there are some signs of an impending shift.



For while he insists scale is important, Mr Sarin notes that it need not be global scale that the company is after; there are also benefits to regional scale. “Is there more scale and scope in Europe versus non-Europe? Of course there is,” he says. “If you go global, especially if you are on different technology, then economies of scale exist, but to a lesser extent.” Mr Sarin notes that both the American and Japanese units are worth more today than they were a year ago. Vodafone's board regularly reviews whether to keep them in the company's portfolio, and has so far decided to do so—though that could change in future. “What we have to do is keep these assets in the fold until there is clear visibility of value that we can take home to our shareholders,” he says. In other words, he just seems to be waiting for the right time to sell.

Repositioning

Vodafone's investments last year—in Romania, the Czech Republic, India, South Africa and Turkey—were all in countries that use GSM technology and have high potential for growth, notes Mr Sarin. By making these investments, and exiting Japan and America, might Vodafone be planning to retrench to Europe and Africa, where its scale provides the greatest benefit? “I don't think of it as retrenchment, but as repositioning,” Mr Sarin responds.

He disagrees that Vodafone has concentrated on expansion at the expense of execution. O2 has been run with more of a short-term strategy, to attract a buyer, he says. And Vodafone's operations in Romania and the Czech Republic were swiftly integrated into the group and are now performing better than expected. But Mr Sarin has signalled the end of his buying spree; he would like to increase Vodafone's stake in Polkomtel, a Polish operator, he says, but does not have anything else on his shopping list at the moment.

What of the suggestion that Vodafone's mobile-only strategy will be undermined by convergence? “It's very early days,” says Mr Sarin. “We are dubious whether customers really want all the things that people are imagining that they want.” Already, he notes, Vodafone sometimes provides fixed/mobile bundles to big corporate customers, by buying capacity from fixed-line operators. The company is also acting as a wireless partner to BT, Britain's fixed-line incumbent, which lacks a mobile network, and may strike similar deals in Italy and Japan. America's Verizon, which owns the other 55% of Verizon Wireless, plans to offer converged services too.

As a result, Vodafone will be able to see how much demand there is for such services. It may be that only a small fraction of customers want them, says Mr Sarin, in which case Vodafone will collaborate with fixed-line operators where appropriate. The company is also keeping a close eye on voice-over-internet technologies. “We are very conscious of that,” he says.

So Mr Sarin has not ruled out change altogether. But whether he will just have to tweak the strategy or rethink it completely remains to be seen. In the meantime, Vodafone's twin pillars remain in place—despite the wobbles.

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Corporate succession

Different shoes

Jan 26th 2006
From The Economist print edition

Nike swaps one leader for another

EARLY in January *Fortune* magazine declared Nike to be one of America's 100 best firms to work for. Weeks later its chief executive, William Perez, begged to differ. He resigned unexpectedly citing differences between himself and the company's chairman (and co-founder) Phil Knight. "You don't need two CEOs," he said. "One is redundant, and I happened to be the redundant one."

It raised eyebrows when Mr Perez, an outsider, was recruited 14 months ago to succeed Mr Knight and to lead the idiosyncratic sports-shoe maker into new markets. Nike was not in trouble and there were internal candidates for the job. (One of them, Mark Parker, a 27-year Nike veteran, will take over from Mr Perez.) But Nike's directors had gone along with the growing enthusiasm in America for appointing outsiders. Martin Conyon, a professor at the Wharton business school, has estimated that outsiders accounted for 15% of all chief-executive appointments in the 1970s, but more than 25% in the 1990s.

Joe Griesedieck, vice-chairman of Korn/Ferry, a firm of headhunters, says it is always wise to look at outsiders when recruiting a chief executive, if only to "benchmark the internal candidates". And there are times when outside appointments are preferable. Scandal-torn Tyco and WorldCom turned to outsiders to signify a fresh start, as did the then enormously loss-making IBM in 1993. Walt Disney was expected to turn to an outsider last year when disgruntled shareholders eventually persuaded Michael Eisner to move, but plumped for an insider, Bob Iger (see article), which some saw as a triumph for the departing Mr Eisner.

The top job at Nike was all the more difficult for an outsider, because the company has a distinctive, hard-to-adopt culture created largely by a man who has stayed on as chairman of the board. At companies such as Dell, Microsoft and Staples, where the founders have similarly moved "upstairs", their replacements have been long-time employees. In a new book, "Building Better Boards" (reviewed on Economist.com), David Nadler, a consultant, says that clearly defined roles are also critical to success in such cases. Michael Dell and Bill Gates, for example, have both concentrated on new technology.

At Nike, Mr Knight may now find Mr Parker's strategic thinking to be more in line with his own. But Rakesh Khurana, a Harvard Business School professor and author of "Searching for a Corporate Saviour", argues that sooner or later companies such as Nike have to find a way to institutionalise the culture of their founders. Apple demonstrated how hard that can be when it failed to thrive without the hands-on presence of its co-founder, Steve Jobs. "The difference between a cult and a religion," says Mr Khurana, "is that one outlives its founder." So far, the creators of the air shoe and the iPod remain mere cults.

Search engines

Here be dragons

Jan 26th 2006
From The Economist print edition

Google enters the Chinese market, practising enlightened self-censorship

IN 2001 human-rights activists in China crowed that a little-known search engine called Google was the most important tool ever created to skirt state censors. Users could retrieve content that Beijing banned by clicking to call up a "cached" copy of the web page, stored by Google. Soon, however, Google itself was being sporadically blocked. The firm was instructed to deactivate that particular feature, and for a short time its web address was even re-routed by Chinese network operators to the website of a local rival.

The continual cat-and-mouse game ended this week when Google, now a corporate giant, entered the dragon's den. On January 25th the search engine "Google.cn" began operations. It is a first step towards beefing up the company's local presence, which will also mean placing computer-servers in the country. This will speed up service for mainland users, who otherwise must penetrate the great firewall of China, which dramatically slows down access to Google.com.

Having local infrastructure gives an advantage to Google's search-engine rivals, such as China's Baidu.com (which enjoys around 40% of the Chinese search market, compared with Google's 30%), and Yahoo! and Microsoft's MSN, which have local Chinese operations. China's internet market, with more than 100m users, is one of the fastest-growing and most lucrative in the world. Can Google—with its motto "don't be evil"—do business in China without betraying its soul?

The company is making a concerted effort to do just that. It has reached an agreement with the Chinese authorities that allows it to disclose to users, at the bottom of a list of search results, whether information has been withheld. This is similar to what the company does in other countries where it faces content restrictions, such as France and Germany (where Nazi sites are banned), and America (where it removes material that is suspected of copyright infringement). Although the disclosure is more prominent on these western sites, putting such a message on its Chinese site is an important step towards transparency and, furthermore, is something its rivals do not do.

Can Google do business in China without betraying its soul?

Moreover, Google is tiptoeing into the country with only a handful of services. It is not offering e-mail, blogging or social-networking services, because it worries that it will not be able to ensure users' privacy. It wishes to avoid the situation in which MSN and Yahoo! find themselves, whereby they are forced to obey the Chinese government's orders in censoring content and revealing users' identities. Rather than be placed in a position where it may have to compromise its values, Google instead is narrowing what it offers (although its news service will contain only government-approved media sources).

Google believes that entering China, even with restraints on content, lets it offer more information than if it remained outside. Yet the decision comes as American internet firms such as Yahoo! and

MSN duck criticism that they are complicit with the Chinese authorities.

For Google, taking the higher road happens to also be a way to differentiate its service. This month America's Department of Justice went to court to force Google to comply with a subpoena seeking more than 1m web addresses and a weeks' worth of all users' searches (down from an original demand of every web address it holds and two months of searches), albeit without any information that would identify individual users. The government wants the data in order to examine the effectiveness of software filters to block pornography, for a case involving a law prohibiting the content, which the Supreme Court ruled unconstitutional.

The government requested, and received, information from Yahoo!, MSN and AOL—all of which initially stonewalled publicly about whether they disclosed the data. Yet Google resisted, arguing that “acceding to the request would suggest it is willing to reveal information about those who use its services. This is not a perception that Google can accept.” The day the subpoena was made public, Google's shares dropped almost 9%, its largest single-day decline since it began trading in 2004.

Google's stance could put commercial pressure on its rivals to adopt more customer-friendly policies, and may serve as a warning to other internet firms to treat customers' data with more care. Yet such high-mindedness will be tested as Google enters China. Keeping its options open, the company is continuing to develop the Chinese-language version of Google.com. It will remain available, for those willing to wait a bit longer for their less censored search results.

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EasyCruise

Sailing in an orange

Jan 26th 2006
From The Economist print edition

A low-cost aviator takes on the cruise giants

THE Caribbean in winter is the world's biggest cruise market, dominated by giants such as Carnival, the world's biggest line since its purchase of P&O Cruises in 2000. It is a booming industry, with 11m passengers last year in America, where the number of cruise ships has almost doubled to 150 in the past five years. Most are floating hotels designed to ensure passengers spend their time—and money—on board. But last summer Stelios Haji-Ioannou, a British entrepreneur, turned the business model on its head to offer only basic onboard accommodation at rockbottom prices to encourage passengers to enjoy themselves ashore.

Now Mr Haji-Ioannou, the founder of easyJet, Europe's first low-cost airline (and of some less profitable ventures such as internet cafés and car rentals), plans to sail a fleet of cruise ships into this lucrative market. At present, he has only one, which plied the Mediterranean in the summer and the Caribbean this winter. But nothing daunts a man prepared to launch a cruise business with a ship packed with cabins the colour of lifejackets—the bright orange of his aeroplanes, cafés, rental cars and everything else in easyworld. Mr Haji-Ioannou is looking for cheap places to dock ships around Miami: “I am more interested in marinas than normal ports,” he says. He is also talking to shipyards about building a fleet of five special 500-passenger vessels at a price of around €30m ($37m) apiece, about half the going rate for a liner. And he is hiring a designer for a new colour scheme.

He needs cheap boats and berths to capture the market he is aiming at. Passengers hop on and off whenever they want and are charged upwards of $45 a night for accommodation only. Passengers can buy refreshments in a basic onboard café and bar, but there are none of the lavish salons and restaurants on a typical cruise liner. Not surprisingly, the typical easyCruise passenger is also somewhat different. The average passengers is 32 years old, compared with 54 on a traditional cruise ship. You probably need youth on your side to party in a different port every night.

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Sushi marketing

Down in one

Jan 26th 2006 | TOKYO
From The Economist print edition

Good fortune comes in long rolls

COME February 3rd in Japan, you might wonder at the strange sight of people trying to face precisely south-south-east while gulping down long, fat sushi rolls in one go. It is a triumph of marketing. The occasion is *Setsubun*, the day before the symbolic start of spring, when people ward off demons and usher in good luck. Like other festivals around the world, it is being commercialised. In Japan *Setsubun* looks set to become as much a boom for stores and restaurants that sell sushi rolls as Valentine's Day has become for other retailers.

The “good-fortune-direction rolls” were originally cooked up by sushi-chefs and makers of *nori* (dried-seaweed, which covers the rolls) in the late 1940s in Osaka. Legend has it that a famous samurai gulped one down before winning a battle. Usually the rolls are cut into chunks, but these cannot be sliced because that would cut good fortune—or so the marketers would have it. The direction that the gobbler has to face is determined by a fortune-telling formula, which shows where the “good-luck” god of the year sits.

A blitz of television advertising and the growth of convenience stores has helped to spread the custom. Lawson, Japan's second-largest chain, sold some 200,000 fortune rolls in 2002 and expects to sell 2.3m this *Setsubun* at ¥380 ($3.30) a time. Seven-Eleven, the largest convenience-store chain, last year saw sales grow by more than a third, to some ¥3m. It is only a matter of time before sushi gulping goes global.

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Livedoor

Melting down

Jan 26th 2006 | TOKYO
From The Economist print edition

Arrests in the livedoor scandal

AP

A gripping tale in Tokyo

SPEED is everything in the information-technology industry. Or so Takafumi Horie, the 33-year-old founder and ex-president of livedoor, an internet and finance company, was fond of saying. Unfortunately for him, Japan's prosecutors seemed to agree. After raiding the firm only a week ago, they arrested Mr Horie on January 23rd with unprecedented celerity. Also detained were Ryoji Miyauchi, livedoor's chief financial officer, and the presidents of livedoor Marketing, a listed affiliate, and livedoor Finance, a subsidiary. They face charges of market manipulation and accounting fraud.

The alleged offences took place in late 2004, when livedoor Marketing skirted disclosure rules by announcing that it was buying Money Life, a publisher, through a share swap—when its parent company in fact already controlled the publisher through a private investment firm. It also allegedly cooked its books to show a profit instead of a loss, reportedly by transferring profits from a consumer-finance arm to boost livedoor Marketing's share price. The prosecutor's office won permission to hold the four executives at a detention centre for ten days for further questioning.

With half of its six board members behind bars, livedoor quickly rushed to reorganise itself. Mr Horie was ousted as president and a new president appointed. He is Kozo Hiramatsu, a 60-year-old former Sony executive who founded an accounting software firm that was bought by livedoor in December 2004, after the alleged financial finagling. On January 25th Mr Horie resigned from the board.

The new management faces a fearsome task. Livedoor, which is on the brink of being delisted by the Tokyo Stock Exchange, has seen roughly three-quarters of its stockmarket value wiped out since the raid. On January 24th its market capitalisation fell below its total asset value of ¥200

billion ($1.7 billion), prompting fears of fresh turmoil as sell and buy orders rushed in. Livedoor's penchant for share splits means it now accounts for almost half of all trading units on the exchange. To counter further trouble, the exchange said on January 25th that it would limit trading in livedoor shares to 60 minutes, after previously cutting it to 90 minutes.

The reverberations from the scandal have sent politicians from the ruling Liberal Democratic party diving for cover. Junichiro Koizumi, the prime minister, was among others who strongly supported Mr Horie when he stood for election last September as an independent. Livedoor itself may now face a takeover bid. It owns more than 50 companies, some of which could be attractive investments.

If the allegations are proved, the repercussions are likely to gather force. Mr Horie had come to stand for a fresh approach in Japan's stuffy ways of doing business. Now some of the old guard are gloating over what they see as the dangers of adopting western, market-based practices. More worryingly, these practices are said by some to have created a polarisation in wealth, symbolised at one end by Mr Horie. Securities fraud and book-cooking are, in fact, thoroughly Japanese traditions. But there might still be a backlash.

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Enron

The drama goes to trial

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From The Economist print edition

The prosecutors of Enron's former bosses have much to prove

AP

Skilling awaits his day in court

KENNETH LAY and Jeffrey Skilling, Enron's former chiefs, this week failed—for the second time—to move their hearing from Houston. Subject to an appeal, the stage is set for the start of America's biggest-ever corporate trial, on January 30th. The spectacular collapse of the energy-trading giant in December 2001, following allegations of a huge accounting fraud, led to a new set of rules governing American business. But the scandal has yet to result in the criminal conviction by a jury of anyone who was a top executive in the firm. If there was a giant fraud, it so far remains unproven in court.

Hence prosecutors have much riding on the case, the result of a four-year investigation. They face a daunting task: in white-collar cases it can be difficult to prove to a jury that defendants knew they were committing a crime, as the law requires. Broadly, their case is that Mr Skilling and, later, Mr Lay led a wide-ranging conspiracy to deceive investors about the true state of Enron's businesses. The two men deny the charge, as well as the allegation that they were seeking to prop up Enron's share price, which had risen from $20 in early 1998 to more than $80 by January 2001. According to prosecutors, Mr Skilling made more than $89m from stock options between 1998 and 2001 and Mr Lay more than $217m.

Mr Lay, Enron's founder, was chairman and chief executive from 1986 until he stood down as chief executive in February 2001. Mr Skilling was Enron's chief operating officer from 1997, reporting to Mr Lay, until he replaced Mr Lay as chief executive. But four months before Enron went bust, Mr Skilling resigned unexpectedly and Mr Lay returned as chief executive.

According to the prosecutors, Mr Skilling was much more active in the alleged conspiracy than Mr Lay. He faces up to 35 charges. These include insider trading and making false and misleading statements about Enron's finances.

Part of the case against him hangs on the allegation that earnings and cashflows were fraudulently manipulated. For instance, prosecutors say, he was involved in manufacturing earnings and concealing debt through sham sales of poorly performing assets to an off-balance-sheet partnership run by Andrew Fastow, Enron's former chief financial officer.

The case against Mr Lay is much narrower; he faces seven charges only. He is accused of taking over leadership of the conspiracy when Mr Skilling left. By mid-September, he had been briefed

about Enron's mounting financial and operational problems, but did not come clean about them, according to the indictment.

Instead, he allegedly made false and misleading statements in two employee meetings, during three conference calls with analysts, and to an analyst from a credit-rating agency. For instance, in October 2001 Mr Lay told analysts that a $1.2 billion reduction in Enron's shareholders' funds stemmed from unwinding a hedging deal; but prosecutors say he knew it resulted from an accounting error by Enron.

In a speech given in December last year, Mr Lay outlined the defence that he and Mr Skilling are expected to adopt: “The investigation is largely a case about normal business activities typically engaged in on a daily basis by...publicly held companies.” Enron's accounting may have been creative or aggressive—but so, the argument goes, was many companies' during the stockmarket boom: it was certainly not fraudulent.

If there was a giant fraud, it so far remains unproven in court

Another line of defence is expected to rest on Mr Fastow's self-enrichment from off-balance-sheet partnerships that dealt with Enron. “It was the stench of possible misconduct by Fastow...that provoked the loss of confidence causing the run on the company's treasury,” Mr Lay claimed. In other words, Enron went bankrupt because Mr Fastow was a crook, not because it was a house of cards.

In building their case, prosecutors obtained guilty pleas from executives just below Mr Skilling. The latest was Richard Causey, Enron's former chief accounting officer, who was to have gone on trial but instead pleaded guilty to one count of securities fraud. Rather than spending up to 40 years in prison (the term had he been convicted of all the charges against him), he will serve five to seven years, depending on how much he co-operates.

Likewise, Mr Fastow, the government's star witness, accepted a ten-year jail sentence under a plea bargain. But defence lawyers may be able to undermine the credibility of witnesses who have an incentive to blame their former bosses, irrespective of the truth.

Finding the credible witness

As conspiracies are by their nature secret, prosecutors often rely on the testimony of co-operating conspirators. And with a conspiracy charge, the prosecution does not have to call a witness for that person's evidence to be heard; under an exception to the inadmissibility of hearsay evidence, conspirators can be used to testify about what they heard another conspirator say. So the credibility (or lack of it) of the government's co-operating witnesses will be an important issue at trial.

The prosecutor's record in cases that have come to court is patchy. Last year the Supreme Court overturned Arthur Andersen's conviction for obstructing the course of justice by shredding tons of documents relating to Enron. This was because the judge's instructions to the jury, which were diluted to reflect the prosecutors' (erroneous) interpretation of the relevant statute, failed to ask the jurors to decide whether Arthur Andersen knew it was doing something illegal. A three-month trial of several former senior executives from Enron's broadband business on charges ranging from securities fraud to insider trading ended last year without a single conviction. Part of the case against Mr Skilling is that he made falsely optimistic statements about this business.

In another trial last year, five out of six defendants, including a former Enron executive, were found guilty of conspiracy to falsify Enron's books through a sham sale to Merrill Lynch of an

interest in three power-generating barges moored off Nigeria. A small part of the case against Mr Skilling is that he pushed through this transaction. The appeals of four former employees of Merrill Lynch against their convictions are due to be heard in March.

But what happened in other Enron cases is not a reliable guide to the outcome in this case. That will be up to the jurors.

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Face value

Looking beyond the mouse

Jan 26th 2006
From The Economist print edition

By buying Pixar, Bob Iger hopes to restore Disney's creative magic

Landov

Get article background

WHEN Bob Iger was chosen to become chief executive of Walt Disney in 2005, many people at the company and in the media business thought he lacked the stature for the top job. One reason why Michael Eisner, the company's former boss, backed him over outside candidates, they suspected, was that he would be a weak successor who would do little to alter his own 20-year legacy. But this week Mr Iger bought Pixar, a successful animation studio, for $7.4 billion in shares of Disney, showing conclusively that he is his own man.

Just a few years ago, Mr Iger seemed nowhere near becoming boss of Disney. He started in television as a weatherman, and slowly rose through the ranks of Capital Cities/ABC before Disney bought it in 1996. As number two to Mr Eisner in his last years at the company, Mr Iger quietly took the blame for the poor performance of ABC, Disney's network-television unit. Even Mr Eisner made disparaging remarks in private about his abilities.

Buying Pixar was an expensive and daring first move. How Mr Iger manages the integration will soon reveal whether he is the sort of leader Disney needs during a difficult period. Like all “old” media companies, the firm faces enormous challenges to its business from the internet and other digital technologies.

As well as ending up with Pixar, Mr Iger is also getting a close relationship with Steve Jobs, who founded Pixar and is the boss of Apple. Mr Jobs had a spectacular falling out with Mr Eisner, but

will now join Disney's board and become its largest individual shareholder. He could provide valuable advice to Mr Iger as he navigates a route through technological change.

Pixar's films have contributed over half of Disney's profits from its studio since 1999, says Merrill Lynch, an investment bank. But their co-production agreement ends this year. Meanwhile, many of Disney's own animation films for children did badly in recent years. The firm has struggled to move away from hand-drawn cartoons to computer-generated images. Buying Pixar means that Mr Iger has at a stroke re-established Disney's pre-eminence in animation. That is vital, because the company needs a flow of new characters to supply its theme parks, its cable-TV programmes and its consumer-products division.

The deal is expensive and will prove worthwhile for Disney's shareholders only if Pixar continues to be successful. But film is notoriously fickle and Pixar has already had a remarkable run of hits, including “Monsters, Inc”, “Finding Nemo” and “The Incredibles”. Mr Iger has to be careful not to spoil its ability to make great films. Often in the past, the “Disney way” of doing things has been stamped on to its acquisitions, with unfortunate results. Previously, with Mr Jobs as a patient, hands-off majority shareholder, Pixar enjoyed the luxury of being able to let the commerce follow the art. Now Disney is likely to put more emphasis on short-term financial results—indeed, one reason why Pixar has done this deal is to avoid having Disney seek to cash in quickly and make bad sequels to its films.

That Pixar is willing to make a deal with Disney, however, shows that Mr Iger has managed to convince the small firm that he is serious about creativity—his recurring theme since becoming chief executive. He has put Pixar's president, Ed Catmull, and John Lasseter, its top creative executive, in charge of both Disney's and Pixar's animation studios, where they will have influence over sequels. Mr Lasseter will also take on a role designing attractions for Disney's parks. Mr Iger will need to keep protecting Pixar's culture, for instance by allowing it to make films at its usual gradual pace. Otherwise, Pixar's creative talent could walk out. “If John Lasseter and other creative people leave, Disney just bought the most expensive computers ever sold,” says Lawrence Haverty, a fund manager at Gabelli Asset Management.

A beautiful friendship

So how did Mr Iger persuade Mr Jobs to sell Pixar? One theory is that Mr Jobs believed the sale would help his favourite firm, Apple. This has much to gain from Disney's content. Soon after Mr Iger became chief executive he struck an unprecedented deal with Apple to allow people to download some of Disney's TV programmes to their iPods through Apple's iTunes online store. Mr Jobs is likely to push Disney to allow more material to be available online. And with Disney about to set itself up as a “virtual” mobile telephone operator, Mr Jobs could gain valuable insight into the process in case Apple decides to do the same thing. But there are potential conflicts of interest, which means Mr Jobs may have to leave some board meetings.

Mr Iger wants Disney to grow internationally, and particularly in emerging markets. Some people reckon the strategy is correct, but that his execution is flawed. “If Disney wants to grow fast internationally it will have to do so in big, mature territories, not just developing markets, but it has been a net divestor of businesses in Europe, which is wrong,” says David Hulbert, former president of Walt Disney Television International.

Mr Iger's most visible characteristic, so far, seems to be that he is far more pleasant to work with than Mr Eisner. As well as restoring relations with Mr Jobs, he ended Disney's damaging feud with Roy Disney, nephew of Walt. Another popular move was to disband Disney's strategic planning department, which was hated internally for blocking new ideas (though it is not completely dead yet, insiders say). Mr Iger is also trying to soften Disney's back-biting corporate culture. Where Mr

Eisner micro-managed, Mr Iger is delegating power to senior managers. So far, he is saying and doing all the right things. There is still a doubt, however, says a former Disney executive, over whether he has the strength to force through difficult decisions and take on entrenched groups at Disney. If he can do that as well, Mr Iger may yet, like Shakespeare's Prince Hal, mock the expectation of the media industry, and frustrate everyone's prophecies.

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Economist.com BUSINESS
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Award: Iain Carson

Jan 26th 2006
From The Economist print edition

Our Industry Editor, Iain Carson, has been named Magazine Feature Journalist of the Year by The Work Foundation, London.

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Actuaries and the pensions crunch

When the spinning stops

Jan 26th 2006
From The Economist print edition

Can actuaries help to sort out the mess in corporate pensions?

AMONG the many jokes about actuaries, one cruelly hits the mark. An actuary and a farmer are looking at two fields of sheep. The farmer asks the actuary how many sheep he thinks there are: “1,007”, is the quick and confident reply. The astounded farmer asks how the actuary reached that number. “Easy, there are seven sheep in that field and about 1,000 in the other.”

False precision and reckless approximation have defined the actuarial profession's role in the crisis that has enveloped corporate pensions on both sides of the Atlantic. Although actuaries have not been the only cause—companies, trustee boards, governments and accounting rules have all played their part—they have been surprisingly hapless at their main task: forecasting funds' future liabilities and assessing how many assets will be required to meet them.

Their failure has hastened the collapse of final-salary (defined-benefit) pension schemes, many of which have ballooning financial deficits. In Britain 70% of such funds have been closed to new entrants in the past few years. Recently, led by IBM in America and Rentokil in Britain, companies have gone further and begun to close schemes to further accruals. As a profession, actuaries stand accused of negligence on a grand scale.

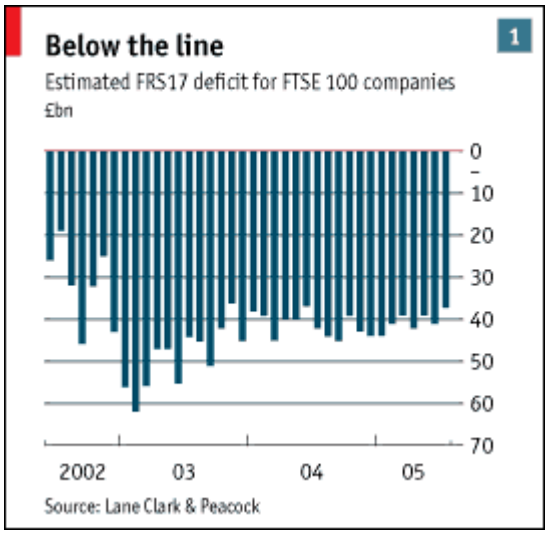
This is truest in Britain, which is where the pensions mess is most acute—and is also where actuaries are laying a path for their colleagues in America and continental Europe on how to put their mistakes right. Since the mid-1990s, the profession has completely recast its ideas and practices, such that Britain is arguably now the world's most sophisticated forum on how to price long-term financial promises and guarantees. This is doubly ironic. First, British actuaries failed

disastrously in their reckoning of these issues during the 1980s and 1990s. Second, many of these ideas came from academic work in America, where the application of modern finance theory to companies and their balance sheets flourished from around 1970.

America has fallen behind mainly because its corporate pensions crisis, though grave, is less severe than Britain's. Fewer retirement benefits there rise in line with inflation, meaning that they are much less expensive in the long run. Only in a few extreme cases (such as General Motors) is the solvency of a big company at risk because of pension liabilities. Further, the pensions industry in America is a shared endeavour, shaped by rules and accounting regulations as well as actuarial practice.

Most members of retirement schemes have little idea of what actuaries do. In essence, they make forecasts across the many variables that affect pension funds. These include not only big factors such as inflation, interest rates, rates of return on assets and how long people will live, but also a host of other more technical things, too. Every three years or so, its actuary calculates whether a fund is in surplus and how its balance has changed since the previous exercise. Pension-fund trustees and sponsoring companies then try to agree on the appropriate level of ongoing funding.

Such “multivariate” forecasting is notoriously difficult—far more so than, for example, guessing the future growth of an economy's GDP. In actuarial exercises, the right question to ask is not whether the overall forecast will be wrong, but by how much it will be wrong. But until the mid-1990s, few people asked this of their actuaries, who tended to act as if they were infallible even while their forecasts were going spectacularly awry. A set of orthodoxies suited the cosy corporate culture of that earlier period, when actuaries endorsed the idea that funds were in healthy surplus, and trustee boards were toothless and saw no need to argue with companies. Most pension schemes held 80% or 90% of their assets in equities, which rose strongly in an inflationary era. Accounting conventions allowed companies to post “profits” derived from the future expected returns on these equities. Although they were not directly responsible, most actuaries were happy to endorse this.

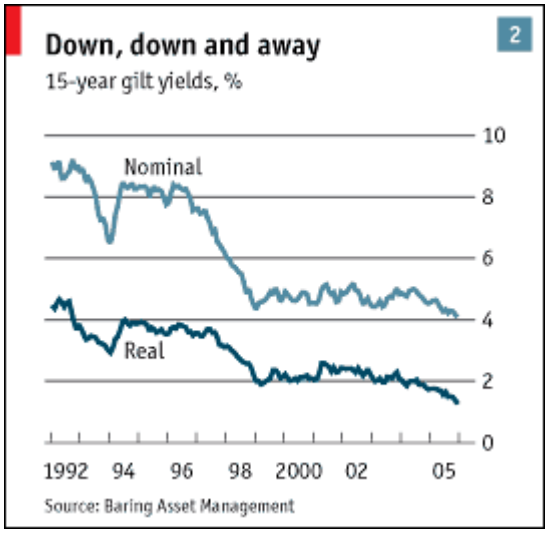


Many companies also used surpluses to justify lengthy “contribution holidays”, meaning the scheme's actuaries agreed that there was no need to put fresh money into their funds. Before the arrival of a robust mark-to-market culture during the 1990s, actuaries were happy to smooth equity values by not writing them down during tough markets and understating them during bull markets (a habit that goes back at least as far as the 1974 stockmarket wobble in Britain, when a collapse in pension assets was overcome by actuarial fiat). They also endorsed the bizarre practice of assuming that holding equities magically reduced a fund's net liabilities, which meant that the sponsoring company could justify lower contributions.

In hindsight—and not just actuaries were slow to spot the role of inflation in allowing it—this was a perverse way to run a pension industry. First, pension funds held assets that, despite outperformance during a period of robust inflation, proved a poor and risky long-term match for liabilities that are bond-like in that they span many years and require reasonably predictable cashflows. Second, by embracing the idea that high returns from equities would lead to lower net liabilities, actuaries set the scene for an overall level of funding that left many schemes vulnerable when equity markets crashed, as they did in 2000-03. In Britain some actuaries went so far as to allow sponsoring companies to assume unusually high returns on their assets, making funds

appear healthy when they were in fact in poor shape.

Some of these orthodoxies have been overturned in recent years. Martin Taylor, chairman of the trustee board of WH Smith, a British retailer, has described the actuarial convention that the composition of the assets should determine the size of the liabilities as “one of the weirdest emanations of the human mind. It's a metaphor—like saying that the advent of jet planes made the Atlantic narrower—and metaphor has limited place in finance.” Plenty of actuaries now agree.



Indeed, the most radical attack on actuaries came from within the profession itself. A defining moment was the presentation to Britain's Institute of Actuaries in 1997 of a paper by Jon Exley, Shyam Mehta and Andrew Smith. In “The financial theory of defined benefit schemes”, they systematically analysed pension funds as part of overall corporate finance theory. Their arguments, which drew on earlier work by academics such as Zvi Bodie of the Boston University School of Management in America, laid the foundations for a completely new actuarial school.

New wares to peddle

According to the new thinking:

•A pension fund should be seen as part of the sponsoring company's balance sheet and risk profile.

•Because funds have tax privileges, shareholders have an interest in wanting them to be fully funded, indeed in modest surplus, so as to maximise that benefit.

•When a company has a pension scheme and accrues liabilities to it, it is in effect issuing long-dated index-linked bonds.

•Assets are worth what the market will pay for them, so £100 worth of equities is worth no more than £100 of bonds.

•The natural assets for a pension scheme are deferred annuities.

One of the strongest arguments made by the new actuaries was to debunk the idea that holding equities somehow reduced a fund's liabilities. They used a simple analogy to show how nonsensical the original thinking had been. Imagine you borrow £1,000 from the bank (ie, a liability) and invest it in equities (ie, assets). Do you owe any less to the bank as a result? Further, do you think you could persuade the bank manager to allow you to make smaller or slower repayments on the grounds that your equities will produce returns in future that will make up the difference? Of course not, said the new actuaries. What a fund does with its assets has obvious consequences, they pointed out, but these do not include altering the value of its liabilities.

To the layman or to observers versed in finance, these ideas might seem obvious. But for actuaries they represented an entirely new way of thinking about pensions. Initial resistance to

the new school crumbled amid tumbling equity markets after 2000. Supposedly healthy pension schemes suddenly had huge deficits, not just as a result of lower share prices, but also because falling real interest rates pushed up the net present value (but not the long-term costs) of their liabilities. Something had clearly been wrong with the actuarial status quo, and that opened the way for advice from a new generation of actuaries.

Lane Clark & Peacock (LCP), a firm of British actuaries, conducts an annual survey of the pension schemes of the biggest British companies. Ninety-two of the top 100 companies that make up the FTSE-100 share index have defined-benefit schemes, and these have mostly lurched into deficit in recent years (see chart one). New pension-fund accounting and valuation rules, known in Britain as FRS17, mean that these deficits are more comparable than they were. The headline deficit of £37 billion in July 2005 represents five months' worth of the companies' pre-tax 2004 profits, a year's worth of dividends, or 3% of the FTSE-100's market value. But LCP argues that the figure is not equivalent to the full extent of the challenge facing companies—add other factors and the total deficit might be as much as one-quarter bigger.

The reason why the reported FRS17 numbers could be much too small may, though, be another case of false precision. If a company tried to walk away from its pension liabilities then it must top up the assets so that the accrued benefits can be fully met by purchasing the appropriate annuities from an insurance company. Just now, this is an expensive option: if all the FTSE-100 companies with deficits went down this route, the shortfall would be nearer £150 billion. A recent estimate by Mercer, another firm of actuaries, put the buy-out costs at twice that—though the new school of actuaries would be the first to point out that this is just a snapshot. If real interest rates were to rise, then annuities would become cheaper and the cost of winding up a scheme would fall.

Actuaries, along with the rest of the pensions industry, have also been surprised by an unprecedented increase in the longevity of pension schemes' members, particularly of a cohort that is now in its 60s and 70s. Obviously the longer people live, the longer they will draw pensions, so this is a critical variable for schemes (as well as for governments trying to finance social-security systems). Greater longevity has also had another, more subtle, effect on pension schemes, because it has led insurers to model more carefully how long people might live and hence to charge a more accurate (ie, higher) price on the long-dated life policies and annuities they offer.

With such an array of pension problems, no wonder many companies developed an aversion to defined benefits. According to Britain's National Association of Pension Funds (NAPF), by mid-2005 about 70% of defined-benefit schemes had been closed to new members; some 9% had been closed to further accruals by members (a trend that has accelerated). Christine Farnish, the NAPF's chief executive, has said that she expects defined benefits to disappear from the private sector within five years.

The deterioration of a once flourishing sector led to political intervention and the introduction of a regulatory framework designed to shepherd pension schemes to safety. This includes a new Pension Protection Fund modelled loosely on America's Pension Benefit Guaranty Corporation. In its first full year it will levy £575m from Britain's pension schemes, as it begins to phase in risk-adjusted premiums that call on healthier funds to pay less than creaking ones. A Pensions Regulator has also given more powers to trustee boards to claw back deficits from scheme sponsors over shorter periods, or to ask for security over other assets such as properties.

That is one of several trends embraced by actuaries that have gradually encouraged pension schemes to become more conservative in the assumptions they make and the assets they hold. One landmark was the decision in 2000-01 by Boots, a retailer, to switch all of its £2.3 billion of assets into a portfolio of long-dated cashflow-matching bonds and to make a linked share buyback

that benefited shareholders. The deal, which proved well-timed and has since had some imitators, was deemed so radical at the time that many actuaries balked at suggesting anything similar to other clients. Coming near the peak in share prices, it was dismissed by many companies as merely a trading strategy. In fact, the deal came after years of internal debate, between Boots' managers and their financial advisers, pension-fund trustees and, yes, actuaries, about how to apply new actuarial ideas.

Many schemes have since been lowering their exposure to equities, investing more in property, private equity, hedge funds and commodities, as well as buying more bonds. At the heart of this trend is a concept known in the pensions business as “de-risking”. At present this is being touted as effectively by investment banks eager for fees as it is by actuaries. The banks see an opportunity to use their financial-engineering expertise to create structured portfolios of assets that are suited to pension schemes' future cashflows. They point out that even though equities have performed well since the end of 2002, funds' health has worsened. The reason is that liabilities have grown even faster than assets. (The accusation that actuaries failed to warn of the growth in liabilities is implicit.)

The solution, argue the banks, is to look more closely at the risks embedded in liabilities and then to reduce funds' riskiness with “Liability Driven Investing” (LDI). The big financial risks relate to inflation and interest rates, while the biggest non-financial risk is changes in longevity. Using derivatives and swaps, the financial risks can be largely stripped out (for a fee, of course) so that funds can be much more certain about their ability to meet future cashflow requirements.

Two LDI pioneers have shown what is possible. Friends Provident, a life insurer, implemented a hedging programme with Merrill Lynch in late 2003. In September 2005 the pension-fund trustees of WH Smith sold all of the £870m ($1.6 billion) fund's assets and invested 94% of the proceeds in a portfolio of interest-rate and inflation swaps, with the balance invested in equity options designed to capture returns from shares over the next decade or so. The company was persuaded to embrace the plan when its advisers explained that the level of risk in the pension fund was so high that the group's solvency could be at stake if things deteriorated.

It is too expensive to reduce long-term risks entirely, so the idea behind LDI is to focus on the big risks and narrow the range of possible future outcomes, limiting the bad ones. LDI is a bit like a hedging programme that zaps the negative effects of interest-rate and inflation risk. There is a range of LDI strategies and structures. In a sense, Boots implemented an LDI programme, but one using bonds rather than snazzier derivatives.

A long squeeze

One problem with LDI is the constraints on the supply of the instruments it uses, particularly when a pension scheme needs to stretch at least 50 years into the future (which is the limit of long-term swaps and bonds). Last year Merrill Lynch pointed out, for example, that Britain has some £700 billion of defined-benefit liabilities, but a mere £7 billion of 35-year index-linked (ie, inflation-proofed) government bonds. As more funds switch their attention to reducing risks, these supply constraints are likely to worsen. In a recent technical squeeze in the market for 50-year gilts, prices have risen so high that real yields have collapsed to historically low levels. This week, for example, the latest auction of 50-year bonds was oversubscribed and offered a real yield of just 0.46%. Demand is coming from pension funds (and insurance companies) looking for very long-dated investments, but also from investment banks seeking to hedge their own LDI-related trading books.

LDI springs from the new actuarial thinking in that it puts the risks in a pension scheme in the context of the sponsoring company's overall risk profile. But actuaries have begun to point out

that LDI is not the answer for every fund. Those with financially strong sponsors, or with sponsors prepared to give pledges or guarantees to their funds, might have no need for a transaction that can be expensive. Moreover, a fund that locks in security at today's high bond prices might come to regret it a decade hence if real interest rates revert to their long-run historical levels.

Even so, the insight that pension schemes need more security is becoming well established in Britain and in America. Ultimately, the old actuaries failed because they did not properly anticipate, calculate and communicate the rising costs of retirement provisions, especially once inflation slowed and real interest rates fell from the mid-1990s onwards. The promise of the new actuaries is that, as their ideas spread, such mispricing will never happen again. If that has come too late for many defined-benefit schemes, at least it might offer a bit more certainty when planning for the next generation's old age.

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Reinsurance

Men in shorts join the fray

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Bermuda's success in attracting capital highlights the competitive shifts under way in the reinsurance industry

"I'M A long way from Hampshire," muses Robert Childs, chief underwriting officer of Hiscox, an insurance syndicate at Lloyd's of London, and head of a new company it has just set up in Bermuda. Hiscox is one of a string of firms to set up shop recently in the British overseas territory, nearly 600 miles (965km) off the coast of America, which has emerged as an important force in the global reinsurance market. "We cannot avoid Bermuda," says Mr Childs. "We've always needed to be at the bazaar."

The competitive threat from Bermuda was acknowledged last week by Lloyd's itself, which unveiled a new strategic plan (belatedly, say some) to counter rival centres. Lloyd's is not alone: Germany and Switzerland, two other giants in reinsurance (the business of insuring insurers), are watching Bermuda closely too. Although the island has been a rising force for 15 years, thanks largely to a favourable tax climate, it has had an extra boost lately thanks to billions of dollars of new capital. Much of this has come from hedge funds and private-equity firms that entered the market expecting prices to rise after Hurricane Katrina. The inflow comes despite stinging losses for some existing Bermudian reinsurers. Their balance sheets were pounded by last year's big storms, which are likely to cost the industry worldwide at least $55 billion.

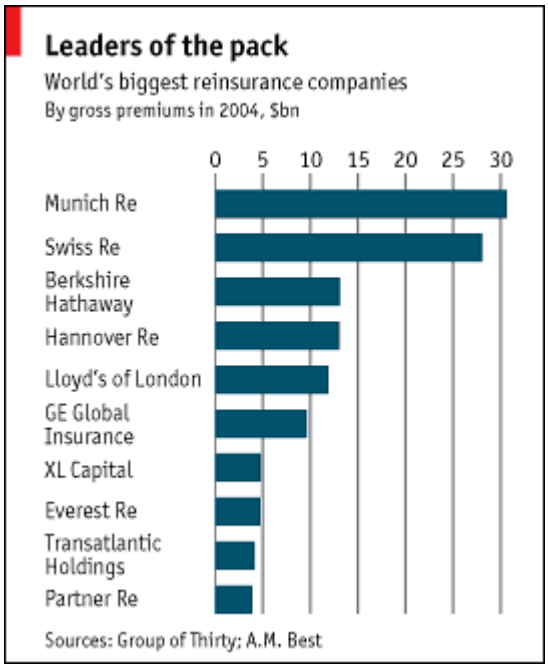
Some of the factors that account for the island's latest boost—the arrival of those new investors and its light regulatory touch—have led to calls for the closer scrutiny of a huge but poorly

understood industry. A report published on January 23rd by the Group of Thirty, a collection of heavyweights in global finance, aims to get beyond what one participant called “an air of mystery” about reinsurance. The group notes how important reinsurance is in the wake of catastrophes, such as the terrorist attacks of September 11th 2001 and last year's hurricanes.

The report answers its most serious question—might this big, relatively opaque industry somehow destabilise the global financial system?—in the negative. However, it points to several areas for improvement, including consistency in regulatory supervision, transparency, risk management and the calculation of capital requirements. It argues that the trend towards securitisation, in which insurance risk is transferred to capital markets, underscores the need for all this.

The rise of Bermuda is by no means the only change under way. Concentration is intensifying. Eight big centres accounted for more than 90% of the $170 billion of premiums written in 2004. The ten largest groups by premiums written (see chart) account for about 60% of the market, up from 40% a decade ago. This effect is greater in life and health reinsurance, which is usually sold directly, than property and casualty, which is sold through brokers and where many smaller Bermudian firms offer specialised cover.

The surge of activity in Bermuda—it lies behind only London and America in writing brokered business, and offers other forms of coverage as well—has made the industry more “atomised”, as some put it. Many firms on the island offer specialised “monoline” coverage, which focuses on narrow sectors such as energy and marine reinsurance. Investors, therefore, are taking on more concentrated risk than they do with the industry's giants such as Munich Re and Swiss Re, which are broadly diversified. Lloyd's writes a dazzling assortment of bespoke direct insurance as well as reinsurance (which is roughly a quarter of its total). Now that General Electric's reinsurance operations are being sold to Swiss Re, America has only one big reinsurer—General Re, owned by Berkshire Hathaway—although America is the biggest source of claims.



Despite the risks, Bermuda has been remarkably successful at attracting equity investors, which is one of the broader industry's main difficulties. Nearly a dozen reinsurance start-ups have been registered on the island in recent months. Several firms have opened for business with as much as $1 billion in new capital. They are focused on parts of the market where price increases are expected, such as marine and energy reinsurance. Low taxes are Bermuda's biggest draw. The vast majority of business written there is from America, where insurers are taxed on the reserves they amass to prepare for large payouts. Increasingly, though, European and Asian business is flowing to Bermuda as well.

Bermuda's appeal is demonstrated by its wide array of backers, which include hedge funds (Citadel Investment Group is backing New Castle Re), private-equity funds and insurers (Trident III and Chubb are behind Harbor Point Re). Aquiline Capital Partners, the private-equity firm of Jeffrey Greenberg, former chief executive of Marsh & McLennan, a big broker, is also backing a Bermuda start-up.

A dose of caution is offered by the big rating agencies, though, some of which express worries about risk concentration in categories with exposure to extreme events. The response in some

cases has been to increase capital requirements. To be sure, there will be consolidation among Bermuda's “class of 2005”—the island's regulations allow capital to leave almost as easily as it enters. But, says Bob Hartwig of the Insurance Information Institute, an industry group, “Bermuda is here to stay.” Bermuda was under pressure several years ago to tighten regulatory standards, but he and others say it has done so satisfactorily. The attractions remain. “Reinsurance is a very capital-intensive business,” notes Mr Childs of Hiscox. “Hedge funds have a lot of capital, and as margins get thinner elsewhere, they've looked here.”

None of this means traditional centres such as London need be deprived of a future. “If you want to establish a long-term, successful business in international insurance and reinsurance, Lloyd's still has unique advantages,” says Miles Trotter of A.M. Best, a rating agency.

Investment in reinsurance, however, is a gamble that may not pay off for everyone, partly because the flood of new capital has made competition even more intense. Although rates have risen in areas of the American market most affected by last year's hurricanes, they have not risen across the board—contrary to what many expected last autumn.

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Oil prices

New friendships and petropuzzles

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Geopolitical uncertainties and murky data are roiling the oil market

AP

"CHINA is one of the most important markets for oil, and Saudi oil is one of the most important sources of energy for China." So declared Saud al-Faisal, Saudi Arabia's foreign minister, as his country's leader, King Abdullah, began an Asian tour this week by meeting China's president, Hu Jintao. Though America is Saudi Arabia's biggest customer and oldest friend, the king's choice for his first official trip outside the Middle East perhaps ought to be no surprise. China is, after all, proving to be an unquenchable customer in the world oil market.

Or is it? China's oil demand certainly shot up in 2004, by 15%. The Chinese economy grew strongly last year, and most commentators assume that oil consumption did the same. That strong growth, along with political crises in Iran and Nigeria, appeared to explain why oil prices have been recently heading towards $70 a barrel again. The latest rally has set the stage nicely for a meeting of the Organisation of Petroleum Exporting Countries (OPEC) in Vienna on January 31st.

Now China has defied expectations again. An official Chinese agency has reported that the country's oil demand fell by 0.2% in 2005. Some market-watchers just don't believe it. Edward Morse of HETCO, an energy-trading firm, stands by his estimate that demand really rose by between 6.4% and 8%. But if the official data are right, then world oil demand is softer than analysts think, and OPEC may have reason to cut output quotas next week.

That is not the only mystery complicating OPEC's decision. The International Energy Agency (IEA), a quasi-governmental body, says that it has lost track of more than a few barrels. In its latest monthly market report, the IEA says it cannot account for 1.2m barrels per day (bpd) of oil in the second quarter of last year or for 900,000 bpd in the third. These sums are in essence the difference between measured changes in physical oil stocks and estimates of supply and demand.

The IEA worries that markets may be tighter than generally assumed and argues that OPEC should release more oil.

Meanwhile, events in two large oil-producing countries are feeding speculation in futures markets. In Nigeria, where militants have attacked oil facilities, at least 200,000 bpd of output is believed to be shut in, and more may yet be. Iran's nuclear ambitions are an even bigger worry. Oil traders fear that if UN sanctions are imposed, Iran might cut its oil exports or disrupt traffic in the Gulf.

Perhaps it is no coincidence, then, that Iran is the OPEC member arguing most vocally for a cut in quotas. There is a good argument for this: global oil consumption typically falls in the second quarter. However, Iran's politics also favours a tighter oil market, through either OPEC or unilateral action. Iranian politicians have intoned that sanctions would hurt outsiders more than Iran.

Saddam Hussein did, on occasion, shut down Iraqi oil exports to gain political leverage. Loss of Iran's oil would hurt far more. Iran's output of 4m bpd or so is bigger than Iraq's ever was. And the world has much less spare capacity now than it did in the 1990s: at 1.5m-2m bpd, mostly in Saudi Arabia, it could not make up for a complete suspension of Iranian exports.

So are higher prices on the way? Quite possibly, although the murkiness of both the data and the politics makes judgment unusually hard. Two factors may rein prices in. One is the Saudis' moderating influence on OPEC: Ali Naimi, the Saudi oil minister, said this week that his country was ready to expand output from 9.5m to 11m bpd quickly if need be. The other is that Iran's mullahs may yet recall that the oil embargoes of the 1970s hurt producers more than consumers. Even Ayatollah Khomeini, who wanted to deny the Great Satan Iran's bounty, learnt that he could not feed his people without selling oil.

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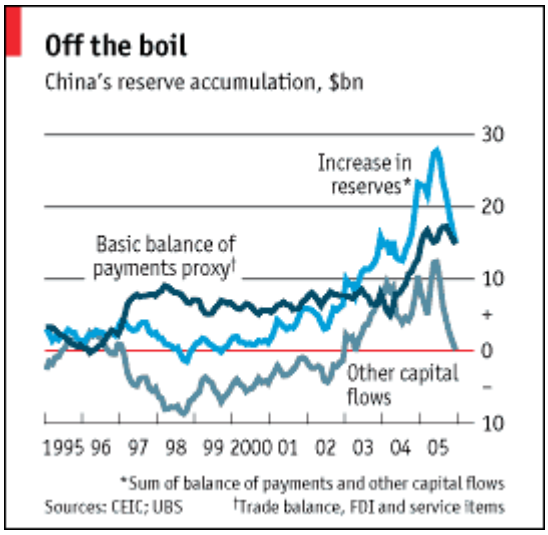
Portfolio investment in China

Cooling down

Jan 26th 2006 | HONG KONG
From The Economist print edition

China's hot-money inflows evaporate



REMEMBER "hot money", the speculative capital inflows into China that threatened to overwhelm its currency peg and even to destabilise its financial system? It is hot no more. Portfolio capital flows into the mainland—foreign currency receipts resulting from neither trade nor foreign direct investment—have dropped to $1 billion a month in the fourth quarter of last year. They averaged $8 billion a month from late 2003 until mid-2005.

This slowdown cannot be explained by a sudden withdrawal of funds by international money managers, since these can invest only very limited sums in China. Nor are large Chinese companies suddenly spending a lot more abroad and repatriating less profit: according to Jonathan Anderson, chief Asia economist for UBS, their behaviour has not changed. The best remaining explanation is that the speculators who have been furiously pumping money into China for the past three years have at last given up and gone home.

There are good reasons for this. First, the hot-money folk were always betting on a long-awaited and large one-off revaluation of the yuan to make them a decent profit. But when China at last adjusted its exchange rate last July, the initial revaluation was a tiny 2%. Since then, China's central bank has made sure that the yuan has remained virtually stable against the dollar. The authorities seem to be in no hurry to move again, leaving speculators little imminent prospect of making money. Meanwhile, the speculators' bet on China has become more expensive to finance. Since mid-2004, American interest rates have risen by three percentage points, while Chinese deposit rates have barely changed. Those investors who borrowed in dollars in order to buy yuan (a "carry" trade) have seen their margins squeezed.

Not everyone investing in China simply parked money in a bank account. Those who bet on property are also coming unstuck. In Shanghai, which owing to its liberal regulatory regime has been the chief destination of such speculative funds, property prices fell last spring. And those who invested in Chinese stocks are having to contend with a sharp slowing of earnings growth, from more than 50% a year in 2002-04 to a rate in low single digits.

All this adds up to more than just one in the eye for speculators. The decline in hot inflows will make it easier for the central bank to manage monetary policy since it can scale back its sterilisation operations—printing yuan to buy up all those incoming dollars, then issuing domestic bonds to banks to mop up the extra yuan and thus hold down inflation.

Quite soon, China's trade surplus may start to fall as import growth revives. Couple that with the evaporation of the hot-money inflows and the country's foreign-exchange reserves might rise by $10 billion-15 billion a month, rather than by nearly $30 billion. In other words, the Chinese would spend less on dollars—and America would have less reason to carp about the exchange rate.

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Russian IPOs

Moscow rules

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A second wave of Russian companies will come to the market in 2006

AT $4.6 billion, the money raised by nine Russian companies through initial public offerings (IPOs) in London last year was little more than an eye-catching trickle. In 2006 there may be a flood. Provided there are no hiccups in investor sentiment, the value of shares that 20 or more Russian firms are expected to sell to international investors over the coming months is set to multiply at least fourfold, to $18 billion-25 billion. First in the queue is Comstar UTS, a telecoms operator, which this week announced plans to sell equity worth a total of $950m-1.2 billion in Moscow and London.

Comstar's final prospectus has not yet been published. However, in many circulars for previous Russian IPOs the “risk factors” run to a few dozen pages. Prospectuses warn of Russia's limited protection for minority shareholders, widespread corruption, incoherent tax code and inconsistent enforcement of the law by courts and regulators. Share dealing by insiders is not a crime, though it can attract modest “administrative” penalties if uncovered. Disclosure standards vary greatly. With such hazards, why are investors so keen?

Rapid economic growth and a vast potential consumer market, replies Gergely Voros, a managing director at Morgan Stanley. As Russia's GDP has grown rapidly in recent years—at an average annual rate of 7% since 1999—so some semblance of prosperity is spreading among a nascent middle class. There are more new Japanese cars than ever in Moscow and people talk about their mortgages in bars—unheard of five years ago.

The apparent enthusiasm of western investment funds for Russian stock is a cause of cheer to the companies' bosses (who are generally owner-managers). Last year they scooped more than $2 billion from placing their own shares. Besides cash, they may hope to gain insurance against the government's predatory behaviour. Companies out of favour can face fantastic tax demands or charges to prevent the withdrawal of necessary licences.

Managers believe that having foreign institutions on their register may discourage the state from taking unfriendly steps. One local economist questions this logic, describing minority shareholders as little more than “hostages” to managers' political conformity. The dismemberment of Yukos, an oil and gas giant once controlled by Mikhail Khodorkovsky, an uppity tycoon now in prison, seems to prove his point. Yukos, after all, had foreign institutions among its shareholders.

Even without state predation, investment in an emerging market like Russia is prone to volatility. For example, Pyaterochka, a supermarket chain in Moscow and St Petersburg, recently had a reversal of fortune. Last May its owners sold global depository receipts (GDRs)—foreign-listed instruments representing shares—worth $639m in its London IPO. The GDRs soared at first, to more than 80% above their offer price—only to plunge by 35% on December 9th. According to UFG, an investment bank, that was the biggest one-day drop for a Russian GDR.

What happened? In September Pyaterochka had indicated that its sales in 2005 would come to $1.6 billion. The company later marked its estimate down by 15%. Its managers' explanations did not avert a stampede. “This was a salutary lesson for us,” says David Noble, Pyaterochka's British chairman, who adds that even after the 35% drop the shares were still above their issue price.

To bolster confidence, some IPO underwriters have encouraged Russian issuers to appoint additional directors, preferably with experience at quoted companies. At more than one company, the absence of a common language means interpreters must provide simultaneous translation at board meetings. How such proceedings capture subtle cultural nuances is unclear.

The big test of demand for Russian assets is expected this summer. Rosneft, a state-owned oil giant chaired by Igor Sechin, one of President Vladimir Putin's closest aides, is planning to sell shares worth an estimated $9 billion-13 billion. This might surpass the $9.2 billion raised by China Construction Bank last October to become the biggest flotation yet by an emerging-market company.

A successful international offering could help deflect concerns about Rosneft's questionable acquisition at the end of 2004 of what used to be Yukos's main production asset and may also make its managers rich. If the IPO goes well, it could also signal the market's confidence in Mr Putin's ability to control the succession at the end of his term in 2008.

Cross-border investment promoting openness and accountability is wonderful, to be sure. But for the time being, investors averse to betting on politics and uncomfortable without western governance standards should probably stand back.

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India's stockmarket scandal

Improper names

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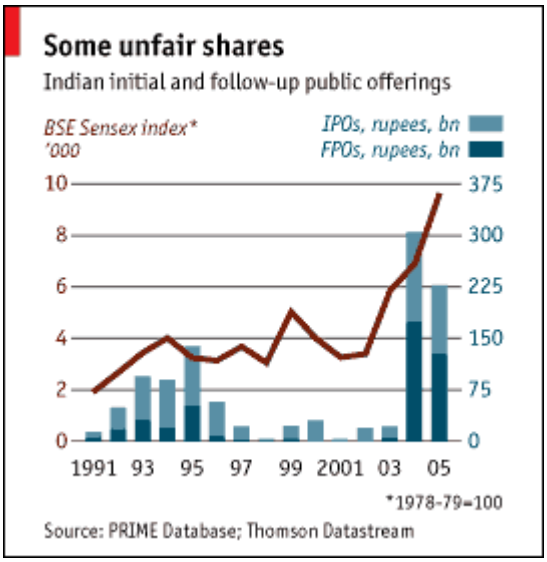
From The Economist print edition

Faith in India's share markets is shaken

LIKE vultures to carrion, so fraudsters to a booming stockmarket. The Mumbai market's main index soared by more than 40% last year and evidence is emerging that some bones were picked clean. The victim, as usual, was the small investor, though at least this time he lost only opportunities, not his shirt.



This week the central bank, the Reserve Bank of India, fined seven banks between 500,000 and 2m rupees ($11,300-45,200) for their roles in the latest scandal. The real penalty, though, was to be named and shamed. It followed the unearthing, by the market regulator, the Securities and Exchange Board of India (SEBI), of what it called “predatory cornering” in at least two “initial public offerings” (IPOs) of shares last year. The banks' lapse had been to violate “know your customer” rules, by allowing individuals to open large numbers of accounts in different names.

Last month SEBI revealed that, in June's issue of 70m shares by Yes Bank, in which 17.5m shares were reserved for retail investors (spending no more than 100,000 rupees), nearly 1m ended up with one woman, Roopalben Panchal, whom SEBI suspects of being a front for unknown investors.

The scam seems remarkably simple, if dauntingly labour-intensive. The retail portion of the issue was ten times over-subscribed. After the shares were allocated, but before they were listed on the stock exchange, Ms Panchal received 150 from each of 6,315 different entities. Curiously, as SEBI noticed, 6,221 of them shared an address in the city of Ahmedabad with Ms Panchal's sister.

Then, this month, SEBI revealed something similar in another IPO, that of the Infrastructure Development Finance Company, last July. More than 43,000 entities transferred shares to Ms Panchal and her “coterie”, which acquired more than 8% of the retail quota. Prithvi Haldea, of Prime Database, a financial-research firm, has calculated that this cut the allocation to genuine small investors, who received 531 shares each, by about 300 shares.

SEBI found it “simply fairytalish” that one person could persuade so many people to make off-market transfers. It concluded that the named account holders were fictitious and that there had been a “manipulative assemblage to scupper the process of IPO allotment”.

The scandal may not stop there. There were many other even hotter IPOs last year. With IDFC

and Yes Bank, SEBI was alerted by the large pre-listing share transfers, which may not have been replicated in other issues. Mr Haldea says the scams have exposed “something terribly wrong in the system”. It could be fixed, he argues, by insisting each investor use a unique identification number, linked to a bank account.

It might also help if more shares were available to small investors. At present large companies seeking a stockmarket listing need sell only 10% of their shares, and only a portion of these are reserved for retail buyers. So the small investor has a tiny slice of the pie, which, it transpires, the vultures want to deny him.

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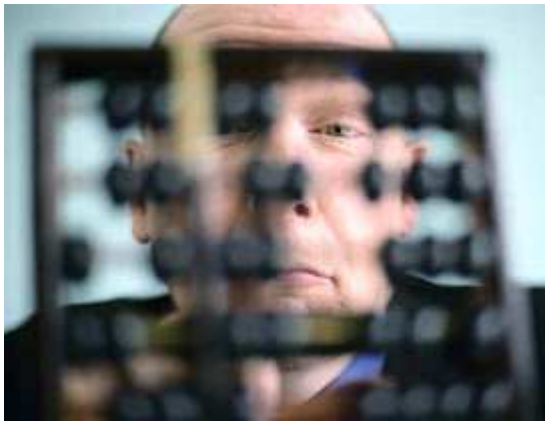
America's auditors

Ticks and crosses

Jan 26th 2006
From The Economist print edition

A so-so grade from the headmaster

Imagestate



I've come to recalibrate your abacus

FEW school pupils would rush to show a test score of 50% to their parents. America's auditors therefore have some explaining to do. Of the 174 auditors inspected by their industry's newish regulator, almost half have been deemed to have some trouble doing their job satisfactorily. On January 19th Grant Thornton became the latest. Fifteen of its audits were found to have significant "deficiencies" and one client had to restate at least part of its financial statements as a result of the inspection.

Some audits by the "Big Four" accounting firms—Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers (PwC)—have also been found wanting by inspectors from the Public Company Accounting Oversight Board (PCAOB), an authority established in 2003 by the Sarbanes-Oxley act. At least 19 of PwC's audits, for instance, were found to include deficiencies. A few clients of each of the four restated their accounts. Smaller auditors also had some problems. One was criticised for its "pervasive failure to plan, perform and document performance of the audit or the quarterly reviews of interim financial information for the first three quarters of the [client's] fiscal year."

The PCAOB does not want to make too much of the results of its first full round of inspections, which have been released in a trickle since early last year. It says it has faith in auditors and that it expected to find flaws because it examined most closely those corners of accounts acknowledged to be the trickiest.

Even so, some of its findings do not reflect well on an industry still trying to rebuild its reputation after the trouble at Enron and elsewhere. "It is not bad news *per se*: the question is whether the deficiencies turn into major problems with an audit... Left on their own, audit firms are not doing as thorough a job as they should," says Haresh Sapra, associate professor of accounting at the University of Chicago's Graduate School of Business.

The auditors retort that the points made in the inspections are a little picky. PwC has said that the suggestions that it failed to get enough evidence to support its audit opinions were wrong two-thirds of the time, because the PCAOB's approach was overly technical. Grant Thornton says that it had "professional judgment differences on the nature, timing, extent and documentation on specific matters".

Some academics have some sympathy with this. The inspectors, they note, focused on grey areas,

such as the calculation of the fair value of assets, that could be criticised by anybody who looked hard enough for a potential misapplication of accounting rules.

Nonetheless, the findings might foster better auditing simply by bringing the industry into the public eye. For instance, Robert Bushman, forensic accounting professor at the University of North Carolina at Chapel Hill, says that auditors had little bargaining power before Sarbanes-Oxley introduced measures to improve the quality of audits. Firms that criticised their clients' accounting risked losing not only audit work but also lucrative consulting contracts. Now power has shifted in auditors' favour. Extra scrutiny of their work makes it easier to reject questionable accounting treatments, lest they draw the attention of the authorities.

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American aid policy

Speak softly and carry a big wallet

Jan 26th 2006
From The Economist print edition

A new man at America's aid agency

RANDALL TOBIAS, the White House's nominee to head America's foreign-aid efforts, is a big businessman with a heart—not the first of that type to win George Bush's favour. His 2003 memoir argues that businessmen often skirt around big issues that are awkward to face squarely. Lots of metaphors are available to illustrate such a problem: the elephant in the room, for example. But Mr Tobias chose to invent one of his own: “Put the moose on the table”, he urged his readers.

Last year politicians and campaigners put global poverty smack on the table. But in the first month of 2006, aidniks have had to face the awkward realities of politics, both in countries that receive money and in those that give it. The World Bank has pulled the plug on Chad, where it has part-financed an oil pipeline, because the government has unpicked the elaborate safeguards meant to ensure the country's oil revenues are well used. And Britain this month decided it could no longer bankroll Ethiopia's government, an aid darling only last spring that has since imprisoned demonstrators and murdered protesters.

Meanwhile, last week Condoleezza Rice, America's secretary of state, announced a tightening of the reins on America's aid. “It is impossible to draw neat, clear lines between our security interests, our development efforts and our democratic ideals,” she said. America's aid officers are therefore to be press-ganged into the cause of “transformational diplomacy”, which concerns itself with the “characters of regimes” rather than just international relations.

Since the Twin Towers fell in September 2001, many have worried that America's aid money would be diverted from combating poverty to fighting militancy; that it would be used to buy allies, not reward reformers. But according to a recent study by the Centre for Global Development (CGD), a Washington think-tank, there is little evidence that the war on terror has greatly distorted America's aid effort. The money it has spent on Iraq, Afghanistan and Pakistan was mostly added to the aid pot, not pilfered from it, they argue.

Under Ms Rice's regime, Mr Tobias will hold the new position of Director of Foreign Assistance. Tucked more closely under the wing of the State Department, he will run the United States Agency for International Development (USAID) and also provide “overall leadership”, as far as the law allows, for the disparate funds, initiatives and corporations that have sprouted on USAID's turf. (Mr Tobias has run one of these, the President's Emergency Plan for AIDS Relief, since October 2003.)

He will have his work cut out. “Bureaucratically fragmented, awkward and slow,” is how President Kennedy described America's foreign-aid effort when he inaugurated USAID in 1961, and much the same might be said of it today. Now, as then, “its administration is diffused over a haphazard and irrational structure” that spans as many as 50 distinct government units, by the OECD's

count.

But worse than this institutional fragmentation is the intellectual disarray that still haunts the aid industry. Development may depend on the “character of regimes”, as Ms Rice argues, but no one knows how to transform them from without, whether by aid or diplomacy. The aid fraternity has persuaded the denizens of Foggy Bottom that development matters. But they have yet to demonstrate that they can reliably engineer it. A moose for Mr Tobias to put on the table, perhaps.

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Economics focus

Passive aggression

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America's shareholders settle for guaranteed mediocrity

HOW many professional stockpickers beat the market? This week, Standard & Poor's (S&P) released its "scorecard" for 2005. Of the 1,137 "large-cap" mutual funds (which trade the shares of big companies), 55.5% beat the S&P 500 stockmarket index last year. Bill Miller's Legg Mason Value Trust Fund beat it for the 15th year in a row.

The cult of equity loves its idols, such as Mr Miller. But Wall Street also has its anti-heroes, who are attracting a growing following. Harry Markowitz and William Sharpe, for example, shared the Nobel prize in economics (with Merton Miller, a corporate-finance theorist) in 1990 for laying the foundations of a disenchanted style of investment, which puts its faith in probabilities, not personalities.

Mr Markowitz showed that it is the portfolio you select that counts, not the stocks you pick. How shares move in sympathy (or antipathy) with each other matters as much as how each performs on its own. Mr Sharpe demonstrated that the best way to escape the quirks of individual shares is not to choose among them at all. Rather, investors should hold all the stocks on the market, in exact proportion to their weight in the market.

To their detractors, this passive style of investing offers nothing more than "guaranteed mediocrity". Investors aspire only to match a stockmarket index, never to beat it. But the guarantee of mediocrity may be more alluring than many suppose.

One gauge of the popularity of passive investing is to add up the dollars devoted to it. According to Financial Research Corporation, an investment research firm, passive funds (some of them exchange-traded) held $879 billion in November 2005. This was a bigger total than ever before, but still just 16% of the sums managed by active funds.

But in a recent working paper*, Utpal Bhattacharya and Neal Galpin, of the University of Indiana's Kelley School of Business, take a different approach—with strikingly different results. They start with the following thought experiment: suppose everyone were a passive investor, slavishly tracking the market, what would share-trading look like? The gap between this hypothetical world and the observed reality of Wall Street provides their measure of how far passive investing has come.

If everyone is a passive investor, holding a portfolio that mirrors the market, the volume of trade in any particular stock should reflect the company's heft in the market—and nothing else. In other words, the market capitalisation of a stock would explain 100% of its dollar trading volume. The intuition is simple enough. Suppose the stockmarket lists just two companies, a small one with a market capitalisation of $25m and a bigger one worth $75m. A passive investor, with $1,000 to

venture, will spend $750 on the larger-cap stock and $250 on the smaller-cap. Likewise, if he were to liquidate a part of his portfolio, he would sell the stocks in the same proportions (three-to-one) to other passive investors, who would buy them three-to-one. Only in this way can the weight of each stock in every investor's portfolio remain the same.

Messrs Bhattacharya and Galpin owe this thought experiment to Andrew Lo and Jiang Wang, of the Massachusetts Institute of Technology. But the two Indiana professors turn the theoretical insight into an empirical measure. They estimate how much of the volume of trade in a share is explained by the company's size. And in so far as size explains volume, passive investing can be said to prevail, they say.

Heroic the assumptions might be; but the results are interesting nonetheless. They imply that American shareholders are giving up the battle to best the market. In 2000-04 passive investing explained at least 76% of the trading volume on the country's stockmarkets, compared with about 64% in 1995-99. Even the tech-heavy NASDAQ, which used to attract the most hyperactive of day-traders, is now as somnambulant as the New York Stock Exchange, with active investing accounting for at most a quarter of trading. Indeed, there is now more guaranteed mediocrity in American stockmarkets than in any of the other 42 countries the authors study, although Belgium, Italy and Sweden are not far behind. In Britain, by contrast, stockpicking may explain half of trading volume; in Germany, as much as 69%.

Quirky and costly

These results pose a puzzle. How can passive investing account for such a big share of American trading, when passive funds hold such a small share of investors' assets? The answer may be that actively managed funds are less active than they claim. Many may be closet trackers, departing from the index only at the edges of their portfolio. There are good reasons for such caution. A stockpicker, if he is to distinguish himself from the herd, must expose his funds to the idiosyncratic risks that rock individual companies and sectors. A passive investor, on the other hand, is vulnerable only to systematic risks that sway the market as a whole.

Despite its rapid progress, the passive revolution will always remain unfinished. As it gains in popularity, it paradoxically loses its appeal. Passive investors free-ride on the efforts of others. They never bother to kick the tyres of the companies they own because they assume someone else has already done so—thus anything they might learn from their toe-poke will already be reflected in the price. But if everyone thinks this way, tyres will go unkicked and prices will cease to reflect all the information they should. This will tempt latent stockpickers back into the game, in the hope of profiting from their private insights. It is only their earnest efforts to beat the market that make the market so difficult to beat.

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* “Is Stock Picking Declining Around the World?”: www.kelley.iu.edu/ubhattac/

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Animal behaviour

The police are a bunch of monkeys

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Simian society, too, needs the forces of law and order

MOST people, even the law-abiding, have ambiguous feelings towards the police. They are a salvation when it comes to protecting life, limb and property, but their efforts are, perhaps, slightly less welcome if your foot happens to slip momentarily on the accelerator. Few, however, would argue that human societies could dispense with their activities altogether. Even in villages, where everybody knows everybody else and social disapproval and the near-certainty of exposure are enough to discourage most criminal acts, the local bobby is a reassuring presence.

Most people, too, would assume such policing is uniquely human. But they would be wrong—at least if Jessica Flack, of the Santa Fe Institute in New Mexico, and her colleagues are correct. For Dr Flack thinks that monkey societies also have police. Moreover, removing those police makes such societies less happy places.

Keystone cops

The police in Dr Flack's monkey societies are not specially assigned task forces, but small coteries of high-ranking individuals. The point about these individuals' behaviour is that, unlike most so-called alpha animals, they do not just defend their own interests. They do that, too, of course. But they also intervene to break up conflicts between lower-ranking individuals in an apparently disinterested way.

Dr Flack had discovered this behaviour in earlier research. Her latest work, just published in *Nature*, looked at how important policing is in maintaining harmony in the monkeys she studies, an Asian species called the pigtailed macaque. To do so, she went to the opposite end of the biological scale from that occupied by ethology (the science of animal behaviour) and borrowed a technique from genetics, called knockout analysis. In genetics, this involves “knocking out” a particular gene and seeing what effect its absence has on a cell's biochemical network. In ethology, it involves removing particular animals from a group and seeing what effect that has on the group's social network.

Dr Flack's troop was comprised of 84 animals (of whom 45 were adults). She knew that three males in the group and one female were on the receiving end of a disproportionate number of acts of submissive behaviour. She also observed that these individuals acted as a police force by breaking up fights. Crucially, they did this by interposing themselves between the opponents, or threatening them both simultaneously and, as far as it was possible to see, impartially.

To look at the effect of such policing, the team first recorded details of the social network between members of the group. They looked at such things as grooming, sitting in contact with or close to others, and play. Then they rounded up and removed the male police for ten hours on a randomly chosen day once a fortnight (they left the female because they thought that removing her would be socially disruptive for other reasons). Ten hours was reckoned long enough for the effects of the police's absence to be noticed, but not so long that the remaining males would start manoeuvring to occupy the vacant alpha positions.

It turned out that policing is the keystone of macaque society. Removing the police resulted in the remaining monkeys grooming fewer others, playing with fewer others and dividing up into cliques as the social network that held the troop together broke down. The number of aggressive incidents also increased.

Dr Flack thinks that the role of policing in these monkeys is to allow individuals to socialise widely at little risk and thus hold a large troop together, since the police will intervene if things get out of hand. The benefit to the police themselves, presumably, is the size of the troop, with the attendant virtues of defensive strength and (for the males) more available females. In simian as in human society, rank hath its privilege—and its obligations, too.

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Recreational drugs

Smoking out the truth

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From The Economist print edition

Why some people smoke more than others do

ANSWERING the question of why people smoke tobacco is reasonably easy. Tobacco plants have evolved a chemical called nicotine that locks into particular molecular receptors in the outer membranes of certain animal nerve cells. Once there, it stimulates those cells in ways that they were never intended to be stimulated. If the animal in question is an insect, the result is lethal—which, from the plant's point of view, is a good outcome. But in a big, bulky animal such as a human, a small amount of nicotine produces a pleasant sensation (though enough of the stuff can kill a human, too).

Nicotine has a second effect, though. It induces semi-permanent changes in the ways the nerves it stimulates talk to each other. The result is that those nerves are uncomfortable without it, and the owners of those nerves become addicted to smoking dried tobacco leaves.

Just how many of those leaves an addict needs seems to vary from person to person, and here the reason is not well known. Or, rather, it wasn't. For Hidetoshi Nakamura of the Tokyo Electric Power Company Hospital, in Japan, and his colleagues have just thrown some light on the issue. In a paper published in the *European Respiratory Journal* they suggest that the number of packs a smoker smokes is a consequence of which versions of a particular enzyme he has in his body—in other words, of his genetics.

The enzyme in question is called, rather inelegantly, CYP2A6. It is part of a family of toxin-destroying enzymes known as the cytochrome P450s, and one of its jobs is to convert nicotine into a less harmful chemical called cotinine that can then be excreted. The gene that encodes CYP2A6, however, comes in three varieties, each resulting in a different form of the enzyme. On top of that, some people lack the gene altogether.

Dr Nakamura and his team looked at 200 regular smokers over the age of 50, to see if the particular varieties of CYP2A6 that those people had could be correlated with their smoking habits. They could. Those with two copies of the commonest form of the gene (one copy inherited from each parent) smoked most. Those individuals with rarer forms smoked less, and those completely without the enzyme smoked least.

That, paradoxically, is because the commonest form of the enzyme is also the most effective at detoxifying nicotine while, of course, an absence of CYP2A6 means that the drug must be detoxified by other, slower, routes. In people with effective enzymes, nicotine vanishes rapidly, so they need another cigarette soon. The less effective the enzyme, the fewer cigarettes you need to smoke to keep your drug levels up. So what natural selection has favoured as healthy may end up killing you faster. But then, there were not many tobacconists in the African savannah where humanity evolved.

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Vehicle technology

Plug and play

Jan 26th 2006 | WASHINGTON, DC
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Cars may soon plug into the power grid rather than the petrol pump

“FORGET hydrogen. Forget hydrogen. Forget hydrogen!” That was the rallying cry of Jim Woolsey, a former director of America's Central Intelligence Agency, at an energy-technology event this week in Washington, DC. He was referring to the idea that America might make itself less dependent on foreign oil by encouraging the development of hydrogen-powered cars. Instead, the former spy-chief has joined a curious coalition of environmental activists, national-security hawks, clean-energy experts and politicians to unveil a national consumer campaign in favour of “plug-in” hybrid-electric vehicles. Another surprising supporter of plug-ins, Orrin Hatch, a senator from Utah and a conservative Republican not known for supporting green causes, also dropped by to declare that this obscure technology could be the “silver bullet” America needs to end its addiction to oil.

The event, and the campaign it was designed to support, are the brainchildren of Austin Energy, a power-generating utility owned by the city of Austin, Texas. Austin Energy's campaign has already won the endorsement of dozens of cities and towns, including Los Angeles, San Francisco and Denver, as well as Austin itself, and also more than 100 utility companies. It now plans to collect millions of signatures from individuals requesting that big car firms start making plug-in hybrids.

Plug-in technology itself is a modified version of hybrid-electric cars such as the Toyota Prius. Instead of relying solely on energy from a petrol engine to charge them up, plug-in hybrids can, as their name suggests, be plugged into conventional power sockets. That allows a plug-in to travel 30-50 miles (50-80km) without petrol, rather than just a couple of miles, as with the Prius. Since most American motorists travel only 20-30 miles a day, they could drive in all-electric mode most of the time. This has the potential to lift fuel economy from the pitiful 20 miles per gallon common in American cars to 80mpg or more. But, as in a conventional hybrid, once the battery was drained, the petrol engine would kick in—thus ensuring that the driver was never stranded.

Enthusiasts reckon that this technology would dramatically reduce oil use (which is why the national-security types are interested) and curb greenhouse-gas emissions (which is why the environmentalists are interested, although this benefit would depend on what method was used to generate the electricity in the first place). And prototype plug-ins developed by the University of California, Davis, by the Electric Power Research Institute (the research arm of America's power industry), and by enthusiasts who have “hacked” Priuses to enable them to be connected to the grid, suggest that the idea can work in practice.

The main obstacle is that the longer range requires a bigger battery, and bigger batteries are heavier and more expensive. Andrew Frank, one of the researchers in the team at Davis, reckons that “retrofitting” a Prius-type hybrid with a big enough battery that uses conventional nickel-metal hydride technology adds about 70kg (150lb) to the vehicle's weight. Using lithium-ion batteries (common in mobile phones) adds less than 25kg, but costs much more. Still, it is an interesting idea, and if it came to pass it would radically restructure America's energy economics by shifting demand from the filling station to the power station. And, who knows, it might even

shift the global balance of another sort of power—the political variety.

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Medical technology

Sharp shooters

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A new device will help locate a patient's veins for injections

TIME is of the essence in an emergency. When medics are treating trauma patients, every second counts. Yet finding a suitable vein into which to make a lifesaving injection can be difficult, and doubly so in the case of someone whose heart is beating only weakly.

Michael Gray, of the Georgia Institute of Technology, in Atlanta, and his colleagues hope to change that. They have designed a cheap, handheld device that should be able to detect veins routinely in an emergency. It works using the Doppler effect—the phenomenon that causes a siren to change pitch when the vehicle sounding it drives past.

Doctors already use the Doppler effect to generate images of blood flowing through the heart. But echocardiography, as this technique is known, requires large, complex and expensive machines to generate sound (actually, ultrasound) in a suitable pattern, pick up reflections from the inside of the thorax, and then stitch those reflections together into a picture of the beating organ. Such pieces of kit are not the sort of thing that can be carried around for use in emergencies.

Dr Gray's scanner, however, can be held in the hand (which inevitably invites comparison with the diagnostic “tricorder” scanners employed by Dr McCoy in “Star Trek”). It has two connected parts. One houses the electronics and the other (which is disposable) the syringe.

Part of the electronics creates a beam of ultrasound that is directed into the patient's flesh—and, with luck, reflected back. The rest of the electronics then interpret the reflected signal. They use the time it takes to return to estimate the depth at which blood is flowing, and they use the Doppler effect to work out how rapidly and in which direction that flow is happening. This allows the device to distinguish between arteries, which carry blood away from the heart, and veins, which carry blood towards the heart. Once a vein is detected at a suitable depth, the device alerts the operator, who pushes the syringe needle into the patient's flesh and injects the medicine.

The device promises to help not only those with heart problems. Doctors and nurses often find it difficult to locate veins in people suffering from dehydration, for example, because the volume of blood in them is lower than normal. Layers of fat make veins hard to find in small children and obese adults. Bruises and burns can also hide veins.

As well as finding veins quickly, the new apparatus could be used to make intravenous injections less traumatic, by getting them right first time. Jim Larsen, one of Dr Gray's colleagues, has a particular interest in this aspect of the work. He recalls having to stay in hospital for numerous blood tests. Each time a nurse took blood, his arm swelled and became more inflamed, making it increasingly difficult for the nurses to find his veins. “It often took seven or eight tries,” he says. “It wasn't long before I felt like a pin cushion.”

The vein finder is not yet in production. It has proved itself on models of human tissue, though, and is about to be tested on the real thing. If successful, it could bring the tricorder that little bit nearer.

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Space and the law

A fall of moon dust

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A sample collected by Apollo 11 almost goes on sale

NASA

Yours for $325 a milligram

"LOT 195 has apparently gone back to the moon. It has been withdrawn from sale." Thus spake Jon Baddeley, head of scientific instruments at Bonhams auctioneers in London on January 24th. Lot 195, by its full description, was "A sample of moon dust from the *Apollo* landing, July 1969." The lot was a small glass phial with a cork stopper containing 31.2 milligrams of dust collected by the first men on the moon. It was attached to an annotated laboratory label. Bonhams estimated its value as £300-400 ($540-715).

The reason for the withdrawal was that the anonymous seller of the sample may not be its legal owner. According to Art Dula, professor of space law at the University of Houston, all samples collected by project *Apollo* belong to the government. In the past, NASA, the government's space agency, has ignored sales of moon dust only when that dust was originally residue attached to clothing or equipment that had itself been acquired by legitimate means. As a result, sales of moon dust and rocks are rare, and rocks from the moon are considered, in one sense, priceless.

In the auction world, of course, everything has its price. But Bonham's estimate was probably a bit on the low side. The Americans spent about $25 billion on the *Apollo* programme, and brought back 382kg of rock. That works out at $65 a milligram, in 1970s dollars—about $325 at today's prices. On top of that, there has been one legal sale of Russian moon rock to act as a benchmark. In 1970 the Soviet Union sent an automated sample-return mission to the moon, and three fragments collected by this mission and weighing 200 milligrams in total were sold by Bonham's rival Sotheby's in 1993 for $442,500. If somebody had managed to snap lot 195 up at the auctioneers' estimate, it would probably have been on eBay for a hundred times the hammer price, faster than you can say "Neil Armstrong".

Although the phial offered for sale by Bonhams contains only a small amount of moon dust, the fact that it is a labelled laboratory sample makes it more likely that NASA would take an interest in the sale than if it had been brushed from a space suit. Mr Baddeley was able to release little information about the anonymous seller. He was a technician who had worked at a laboratory where the sample had been kept until it was of "no further use". However, according to Mr Dula, the only way anyone other than the American government could legally own it would be for that government to have transferred ownership formally. In any case, he adds, federal property that is "surplus" must, by law, be sold—not given away.

The sale was halted after *The Economist* called Bonhams to inquire about this legislative wrinkle. On Tuesday afternoon a spokeswoman for Bonhams said the firm was working with the vendor and the American embassy to “clarify the title” of lot 195. The embassy and NASA declined to comment, although the agency is investigating the matter.

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The Richard Casement internship

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We invite applications for the 2006 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words that they think would be suitable for publication in the Science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. Applications must reach us by February 25th. They should be sent by e-mail to casement@economist.com

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The British royal family

Gorgeous George

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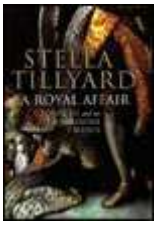
George III's eight brothers and sisters were every bit as troublesome as the American colonists who plagued his reign, as a new royal family saga shows

A Royal Affair: George III and his Troublesome Siblings
By Stella Tillyard



Chatto & Windus; 480 pages; £20. To be published in America by Random House in December

Buy it at
Amazon.com
Amazon.co.uk

IT IS Alan Bennett, and his “The Madness of King George”, who is to blame for the image of George III as a cartoon of inherited malady, all purple urine and verbal spasm. So Stella Tillyard's book comes as a timely reminder that, long before the king screamed down the corridors at Windsor or chased ladies-in-waiting at Kew, he was a working monarch who steered Britain through decades of choppy waters.

Ms Tillyard's interest, however, lies not so much with the big upsets of George's long reign—the endless Whig infighting, economic jitteriness and, of course, the loss of America—but with a parallel set of dramas within the king's own family. For while George was a husband and father of earnest strenuousness, the majority of his eight siblings turned out to be a giddy and ill-behaved crew.

As head of the family from the age of 22, it was George's job to watch over his brothers and sisters as both their monarch and paterfamilias. Indeed, the two functions were intimately linked, for, as Ms Tillyard repeatedly points out, belonging to the royal family meant playing a double-jointed role. For a prince to divorce his wife was not merely a private sadness but a constitutional bonfire; an illegitimate child was not simply a source of embarrassment but quite possibly the rallying point for revolution or invasion.

By far the largest part of Ms Tillyard's book concerns the story of the king's youngest sister, Caroline Mathilde, the teenage bride of the mad king of Denmark, Christian VII. The story of how Christian was manipulated by an ambitious German doctor-courtier, Johann Friedrich Struensee, who became Caroline's lover, was told in Per Olov Enquist's exquisite hit novel of 2001, “The Royal Physician's Visit”. Here Ms Tillyard carefully rounds out Struensee's intellectual trajectory, showing him to be a creature of the Enlightenment, who put man—a sensory, sensual man—rather than God at the centre of the universe.

Struensee managed to overhaul Denmark's public life, transforming it from virtual medievalism into the most liberal court in Europe. The story ended badly, with the good doctor put to death as a traitor and Caroline Mathilde exiled to Hanover, the British monarchy's ancestral home. King George's task throughout the whole sorry business had been to achieve a balancing act between making it clear that he disapproved of his sister's sexual exploits (she had a child by Struensee) and ensuring that she was still treated with the dignity she—that is, Britain—deserved.

Caroline Mathilde's brothers did little better. The Duke of Cumberland fell in love with the wife of

Lord Grosvenor, triggering not only a great deal of tittering in the popular press but an embarrassing court case, as a result of which he was found guilty of “criminal conversation” and fined £10,000. (The sum imposed would have been much higher, but since everyone knew that Cumberland was broke and the money would come out of the public purse there didn't seem much point.) He then compounded his misdemeanour by marrying a British commoner without the king's permission, thus squandering an opportunity for Britain to make a tactical foreign alliance. At least Cumberland had the decency to stick by his bride: his elder brother, Prince William of Gloucester, also ran off with a commoner before abandoning her for someone equally surplus to requirements.

Throughout all these worries, which George met with a sulky stoicism as he juggled the needs of the nation with his siblings' unruly desires, there was the far louder rumble of America's growing independence. Since the king looked upon his subjects as his own children, the demand of the colonists to separate from Britain struck him as the worst kind of filial ingratitude. And yet, once obliged to accept the inevitable breach, he behaved with all the quiet if wounded dignity of a grandfather who realises that the time has come when his powers are on the wane. One of the most evocative passages in this psychologically acute book concerns the presentation in 1785 of John Adams, the new American ambassador, to King George. Both men are nervous, both convinced that their nation has right on its side, yet both strain to set this new relationship between equals off on the right track. It is here that Ms Tillyard's lush prose serves her best, taking the reader deeply into a scene which, no matter how constitutionally momentous, actually consists of two nervous middle-aged men in an over-furnished drawing-room fumbling towards understanding.

In deciding to tell the history of George and his siblings, Ms Tillyard has set herself a difficult task. The story of Caroline Mathilde is by far the richest, but it means that her brothers are lost from sight for chapters on end. The final result is, in effect, a series of interlinked biographies of vastly different lengths, adding up to a portrait of the British royal family during three decades of the 18th century. This approach suits Ms Tillyard well. “Aristocrats”, her 1994 group biography of the Lennox sisters, was a thunderous success. After a break, writing a life of Edward Fitzgerald, she has returned to what she knows—and does—best, teasing out the bonds of love, hate and pretend indifference that bind siblings, no matter what their historical pedigree, into a cat's cradle of consequence.

A Royal Affair: George III and his Troublesome Siblings.
By Stella Tillyard.
Chatto & Windus; 480 pages; £20. To be published in America by Random House in December

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The Getty Villa

Fancy and free

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From The Economist print edition

The much married oilman's home reopens

FORGET the charges of looted art-works, staff defections and low morale—at long last the J. Paul Getty Trust has some good news to broadcast: the reopening on January 28th, after almost nine years, of the Getty Villa, nestling on a hillside just above the Pacific. The villa, modelled after a Roman country house that was buried by an eruption of Vesuvius in 79AD, is already a hit with the public. Admission is free, but places must be booked in advance; tickets for the next three months are already taken.

The public's instinct will doubtless prove correct, especially when the California sun is shining and the gardens are fluttering with monarch butterflies. The architects have “re-imagined” the old villa, building a new entry pavilion into the side of the canyon and nearly doubling the size of the site's facilities. One clever touch (some might say pretentious) through much of the site is the use of “strata walls”, horizontal layers of different stone, concrete and wood that are meant to suggest the layers of an archaeological dig.

Scholars, who benefit from ample research facilities, should be happy, too. With the Getty Centre now free to concentrate on European painting, photography and other more modern matters, the villa houses the Getty's impressive collection of some 44,000 Greek, Etruscan and Roman antiquities—and is putting over 1,200 of them on display.

So is there anything to spoil the picture? Unhappily for the Getty, questions of disputed provenance—the very thing that has landed Marion True, the former antiquities curator, in an Italian courtroom—have yet to be resolved, and they concern several of the prize objects, including a statue of Aphrodite and a Greek funeral wreath, on display at the villa. Michael Brand, the new director of the Getty Museum, takes a resigned view: museums around the world have the same problem and questions of who properly owns what go back to at least the Romans. No doubt that would include Lucius Calpurnius Piso Caesoninus, father-in-law of Julius Caesar and supposedly the owner of the villa at Herculaneum, south of Naples, that first inspired John Paul Getty.

The Getty Villa is at 17985 Pacific Coast Highway, Pacific Palisades, California. Tickets can be obtained at www.getty.edu or by calling +1 (310) 440-7300.

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American politics

Right-ho

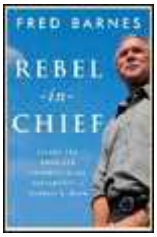
Jan 26th 2006
From The Economist print edition

ONE of the most depressing consequences of the polarisation of American politics is that it is turning once excellent writers into partisan hacks. Nobody expects the likes of Ann Coulter or Michael Moore to produce anything other than *parti pris* piffle. That is their nature—just as it is the nature of dogs to bark and skunks to stink—and you know what you are getting when you hand over your dollar. But Fred Barnes is different.

EPA

Bush raises the right

Rebel-in-Chief: Inside the Bold and Controversial Presidency of George W. Bush
By Fred Barnes



Crown Forum; 224 pages; $23.95

Buy it at
Amazon.com
Amazon.co.uk

Mr Barnes is a conservative, to be sure. But he is an intelligent and insightful conservative, not a common hack. He is the executive editor of America's most interesting conservative magazine, the *Weekly Standard*; he is also a compelling political analyst, with a finger on Washington's pulse and an encyclopedic knowledge of American psephology. Which is all a roundabout way of saying that “Rebel-in-Chief” is a disappointment.

The problem is partly a matter of style. Mr Barnes gushes over his “insurgent leader”—and then supports his gushing tributes with even more gushing tributes from Mr Bush's staff, as if they meant something. But a problem of style rapidly becomes a problem of substance. The political sage of the *Weekly Standard* does not go so far, say, as North Korean Communist hacks when they praise Kim Jong Il as a hero for the ages. Mr Barnes is at least open to doubt. But he leans in that direction. “We know some of his policies have worked in the short run”, he writes at one point. “His tax cuts, for instance, helped lift the economy out of the doldrums. And his foreign policy liberated Afghans and Iraqis from the grip of tyranny. What we don't yet know is whether Bush made the world a better place, permanently.”

One of Mr Barnes's silliest proposals is to portray Mr Bush as a rebel against the permanent Washington establishment, “an alien in the realm of the governing class”, “an insurgent, with few ties to Washington”. He goes on: “The media—top reporters, columnists, TV commentators—are the shock troops of the establishment”, and they are backed up by vast armies of lobbyists, lawyers and people with names like Nelson Strobridge Talbott. But don't Mr Bush's “few ties to Washington” include a father who was president and a grandfather who was a senator? Doesn't Mr Bush's cabinet include such Beltway fixtures as Dick Cheney and Donald Rumsfeld? And isn't Mr

Barnes a cheerful member of the permanent Washington establishment, with a high-profile slot on Fox News and an office in the same building as the city's most influential think-tank, the American Enterprise Institute?

However, in the peculiar world of political commentary the fact that a book contains a lot of nonsense does not mean that it should be ignored altogether. Just as old-fashioned Kremlinologists used to read through hagiographies of Yuri Andropov in order to understand what was happening in the Politburo, so it is worth reading through “Rebel-in-Chief” in order to know what is going on in Bushworld. Two things come through clearly.

The first is that Mr Bush is obsessed by the idea of being a “transformational” president: not just a status-quo operator like Bill Clinton but a man who changes the direction of history like Franklin Delano Roosevelt and Ronald Reagan. This drive to be a transformational figure led to his overreach in trying to reform the Social Security system. It will also ensure that he won't back down over Iraq. For a man who prides himself on being just a regular Texan, Mr Bush spends a lot of time reading presidential biographies.

The second is that, for all Mr Bush's recent dips in the polls, his supporters still think that they have a chance of cementing a Republican majority in this year's congressional elections. They think that they have political geography on their side. Mr Barnes quotes Karl Rove defining a typical Republican community. “Show me married couples with kids living within five miles of a Wal-Mart, a Barnes & Noble and a Linens 'n Things, or a Home Depot with an Applebee's or a Cracker Barrel on the interstate nearby and a growing church in the neighbourhood, and you've got a Republican neighbourhood.” That is an awfully large chunk of America (and not one that is impressed by Democratic campaigns to demonise Wal-Mart).

They also think that they have come up with a winning formula in big-government conservatism, which, in their view, is succeeding in both marginalising the Democrats and winning over down-market America. Mr Barnes points to the emergence of a new Republican voting block: pro-government conservatives. In the past, this sector—which is poorer than traditional Republicans—has been right-leaning on social issues and foreign policy but left-leaning when it comes to government activism. Now big-government conservatism is turning this vital swing group, which makes up about 10% of the voting population, into a permanent part of the Republican constituency. This is all interesting stuff; shame that you have to wade through so much treacle to find it.

Rebel-in-Chief: Inside the Bold and Controversial Presidency of George W. Bush.
By Fred Barnes.
Crown Forum; 224 pages; $23.95

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New fiction

Distance and intimacy

Jan 26th 2006
From The Economist print edition

OUT of India's seething hotch-potch of humanity Thrity Umrigar has created two vivid female characters, each representative of thousands of real-life Indian women.

Sera Dubash is an upper-middle-class Parsi housewife. She lives a privileged life in an affluent Mumbai household with her happily married daughter and son-in-law. Bhima Gopal is Sera's servant. She is old, poor, tired: “dried out, scooped out, as hollow and wrinkled as a walnut shell”. Each morning she leaves her mud-floored hut in the squalid slum where she lives to cook and clean at Sera's house.

At the heart of this novel is the symbiotic relationship—the essence of distance and intimacy—between Sera and Bhima which, after 20 years, remains defined by their differing class, education and wealth. Although she is thought of as one of the family, Bhima polishes furniture she is forbidden to sit on and washes cups she may not use. She has her own utensils and a private bar of soap. When the two women drink tea together Sera sits at the table while Bhima squats on the floor.

The Space Between Us
By Thrity Umrigar

William Morrow; 336 pages; $24.95.
Fourth Estate; £14.99

Buy it at
Amazon.com
Amazon.co.uk

In spite of these differences their lives have many parallels. Both have watched “the bloom fade from their marriages”, both have supported one another in times of hardship, and both have pinned their future happiness on the younger generation, a dream that splinters like a shattered mirror when their loyalty to their families and to each other is cruelly tested.

This ultimately tragic story is told against the vibrant backdrop of modern Mumbai, an exuberant metropolis of 12m, which Bhima now barely recognises: “something snarling and mean and cruel had been unleashed in it.” The book's pages glow with descriptions of the city. Iridescent colours, noise, the smell of frying bhelpuri and everywhere people, people, people—office workers, street urchins, legless beggars, nut vendors, slum dwellers, balloon sellers, call-girls in high heels, brash T-shirted teenagers—the common currency of the developing world.

The author prevents her story from descending into emotional soup by tackling, across the span of her characters' lives, many of the issues affecting India today: poverty engendering poverty; the power of privilege and wealth; domestic violence; class; education; women's rights; AIDS. This adds richness, making “The Space Between Us” far more than an analysis of fate and a portrait of the bonds of womanhood. It is also a powerful social commentary on the glorious and frustrating jigsaw puzzle that is modern India.

The Space Between Us.
By Thrity Umrigar.

William Morrow; 336 pages; $24.95.
Fourth Estate; £14.99

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The proconsul's tale

A crumby account

Jan 26th 2006
From The Economist print edition

A COUPLE of times during the 14 months that he ran Iraq, Paul Bremer sat down to write to his boss, Donald Rumsfeld, America's defence secretary, about troop figures. He needed tens of thousands more American troops to provide basic security, he said. He received no reply.

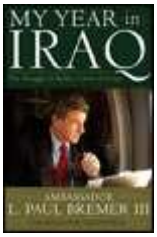
Meanwhile, Iraq and the Coalition Provisional Authority that Mr Bremer led lurched between worsening fiascos. Sunni terrorism and Shia insurgency flickered and spread. Provision of basic services plummeted to below pre-war levels. Mr Bremer says he was made false promises by a number of Iraqi leaders, including former exiles like Ahmed Chalabi, whose followers won not one seat in Iraq's elections last month. At the end of his tour of duty, still struggling to offload sovereignty to these men, Mr Bremer admits: “We've become the worst of all things—an ineffective occupier.”

Upstanding and devout, this former American ambassador to the Netherlands seemed horribly out of place at times. He took up the job in May 2003, having been appointed at short notice after looters had despoiled Baghdad and a retired US Army general, Jay Garner, had proved he could not cope. Mr Bremer had little prior experience of failed states, peacekeeping or Arabs, and he struggled to comprehend a people whose first concern, once granted their freedom, was not the public good. His determinedly fixed grin is painful to imagine as he describes a crafty Shia imam as “a Jesuit priest masquerading as an elf.”

Worse, he will be remembered for two calamitous orders which he issued within days of arriving in Baghdad. The first banned some 35,000 members of Saddam Hussein's Baath party, including doctors and university professors, from government jobs; the second disbanded Iraq's army. Looking back, this last was an idiotic act, for it created both a security vacuum and insurgents to fill it. Mr Bremer tries in vain to justify the decision. He argues that the Iraqi army had already scattered long before the Americans advanced. Yet, months later, senior American commanders were still debating whether to recall it. He argues also that the Kurds would never have accepted the army being recalled; yet they could not have prevented it. Finally he suggests, more reasonably, that the decision was made for him by others.

It was the brainwave of Douglas Feith, under-secretary of defence for policy, supported by both Mr Rumsfeld and his deputy, Paul Wolfowitz. That these individuals subsequently tried to blame Mr Bremer for the debacle was calumnious, but it does not let him off the hook. It remains unclear, for example, why he did not take his request for more American troops directly to George Bush, to whom he spoke regularly. The president, incidentally, emerges from this account as a likeable cove, given to strong statements of his unflinching resolve, but limited in his understanding of Iraq. Of the rebellious Sunnis, he wonders: “Don't they want to live in peace like everyone else?”

My Year in Iraq: The Struggle to Build a Future of Hope
By L. Paul Bremer and Malcolm McConnell



Simon & Schuster; 417 pages; $27 and £18.99

Buy it at
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Amazon.co.uk

Though filled with quite interesting details, Mr Bremer's book is rather like his time in Iraq: conscientious rather than inspiring, lacking in vision and ultimately unsatisfying. He offers no arresting view on the rightness of America's cause. The dialogue he quotes is implausible—take, for example, this senior British police officer: “It's just not on, Sir...The gentleman is a proper bull in the china shop.” As for his anecdotes, the most amusing involves Mr Bremer being scolded by Condoleezza Rice, the national security adviser, for dropping crumbs in the Oval Office. Hardly stirring stuff.

By L. Paul Bremer with Malcolm McConnell.
Simon & Schuster; 417 pages; $27 and £18.99

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Victor Salvi's harps

Lord of the strings

Jan 26th 2006 | PIASCO, NORTHERN ITALY
From The Economist print edition

A new harp museum celebrates a remarkable invention

THE harp is such a handsome instrument that some are sold simply to decorate a room. Heretics who do not like the ethereal elegance of harp music often say that it looks better than it sounds. It is true that, compared with the piano, the range of its sound and its repertory are small—largely because a concert harp has only 47 strings while the average, modern piano has more than 230 for 88 keys. But there is no shortage of harpists, and sales of the instrument are rising steadily.

Harps just for looking at can now be seen in a museum in a small town called Piasco, in the Alpine foothills of north-west Italy, not far from the French border. The museum is named after Victor Salvi, an energetic, balding figure with a grey beard, who was in Piasco recently to inspect the museum's premises, and to reminisce about a life dedicated to the harp.

The instrument is in his blood. His father made harps in Viggiano, a town in the Campagna which grew prosperous from the manufacture and playing of musical instruments. In 1913, the family emigrated to Chicago, where Mr Salvi was born in 1920. By then, his elder brother was already playing the harp professionally. “The kid was a genius. He was making $1,000 a night, until the Depression.”

Mr Salvi was no mean player himself: harpist for the New York Philharmonic under Arturo Toscanini and Dimitri Mitropoulos. But Mr Salvi is a restless man, bubbling with curiosity and initiative. When he decided that the repertoire for orchestral harpists did not stretch him enough, he quit in his prime and left for Italy. He had repaired harps in New York; now he began to make them, in Genoa.

His move to the country came because baroque-style furniture had been a speciality in Piasco and he wanted to exploit the skill of the cabinet-makers who lived there. The inlaid decorative woodwork of some of their harps has already turned them into museum pieces. To safeguard the supply of cow-gut for the harp strings, Mr Salvi bought a small British company that produced it. (It takes the gut of more than two cows to string one harp.) When Lyon & Healy, harpmakers in Chicago since 1889, were in trouble, Mr Salvi bailed them out.

The Victor Salvi Foundation was set up in 2000, by which time Mr Salvi had become the world's great impresario of the harp. The foundation, run by his Colombian wife Julia, awards scholarships, sponsors competitions and commissions new work. Students can rent a harp, and Mr Salvi notes that most of them are now young women—smaller hands are more agile over the strings.

The museum houses a couple of dozen of the many harps that Mr Salvi has purchased on his travels. “I never thought about having a collection. I bought harps because they were so beautiful,” he says. There are historic pieces, such as the double-action pedal harp made by

Sébastian Erard, a Parisian who fled to London during the French Revolution. (Seven pedals at the base of the sound-box enable a harpist to raise the pitch of each string by one or two semi-tones in a range of 6½ octaves.)

Perhaps the most beautiful of all is a harp made in 1820 by John Egan in Dublin, which incorporates some of Erard's innovations without losing the graceful lines that caused the harp to be chosen as the emblem of the Irish nation and of Arthur Guinness's stout. Mr Salvi bought it in an Oxford antique shop when taking his son to university. Victor Salvi's harp museum celebrates musical perfection—and is a memorial to a remarkable life.

Museo dell'Arpa Victor Salvi is at Via Rossana, 7, Piasco, Italy. Tel: + 39 0175 2705101. Further information is available at www.museodellarpavictorsalvi.it

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Ibrahim Rugova

Jan 26th 2006
From The Economist print edition

Ibrahim Rugova, president of Kosovo, died on January 21st, aged 61

EPA

DURING the worst years of the Bosnian war a very strange, almost Ruritanian drama played itself out in another part of the dying Yugoslavia. In 1992 Ibrahim Rugova was elected president of Kosovo.

Once installed, he was driven to work in a black presidential Audi. His office issued daily communiqués about whom he had seen and what he had done. Ordinary people came to pay court and ask favours of the man they increasingly came to regard as the father of the nation.

And it was mostly fantasy. Mr Rugova had been elected president by Kosovo Albanians in a poll conducted in private houses. It was deemed illegal by Serbia, of which Kosovo was, and technically still is, a part. Mr Rugova's office was a wooden bungalow reached by skipping around muddy puddles behind the football stadium in Kosovo's capital, Pristina. No country in the world recognised Mr Rugova's claim to be the president of an independent state, save neighbouring Albania.

But it worked. Any week now talks are due to begin, organised by the United Nations, which are likely to take Kosovo a giant step closer to full independence. Of Kosovo's 2m people, more than 90% are ethnic Albanians.

Those years in the bungalow were strange indeed. While Serbian security forces prowled through Pristina in armoured personnel carriers, Mr Rugova and his colleagues plotted how to make their phantom republic real. They organised a parallel schooling system and health-care network which employed ethnic Albanians who had either been sacked by the oppressive regime of Slobodan Milosevic or had refused to work for the Serbian state any longer. At the same time, Mr Rugova

kept in touch with a government-in-exile in Bonn which raised taxes to pay for all this among the Kosovo Albanian diaspora. A few men were sent to train as soldiers in military camps in Albania.

Mr Rugova gathered clever men around him and took a keen interest in his people's welfare. He himself inspired fierce loyalty and devotion. But to meet or interview he was phenomenally dull. His only topic was Kosovo's need for independence. In later years, especially after 2002 when he was formally elected president of Kosovo (since 1999 under UN jurisdiction), he often seemed more excited by his mineral collection than by humdrum daily politics. Visiting diplomats and foreign dignitaries could work out their relative importance to him and to Kosovo by the size of the rock he would give them as a gift.

His patriotism was imbued young. He was barely six weeks old when, in 1945, his father and grandfather were executed by Communist partisans taking over Kosovo. In 1976 he spent a year in Paris studying under Roland Barthes. He returned to Kosovo to become a professor of Albanian literature. From then on, he cultivated a bohemian air. He always wore a silk scarf, except in August. He was partial to drink and a heavy smoker, which may explain his death from lung cancer.

He became head of his party, the Democratic League of Kosovo (LDK), almost by accident. When it was formed in 1989 he was despatched to ask Rexhep Qosja, a prominent nationalist writer, to lead it. Mr Qosja refused and, to block anyone worse, the party's founders gave the job to Mr Rugova. “He was a total outsider,” recalled one journalist in the group. “He was a kind of loser who sat in the corner drinking too much coffee.”

Surprised by war

During the 1990s Mr Rugova urged peaceful resistance to Serbian rule. For this he was regarded as the “Gandhi of the Balkans”, especially when its other leaders seemed bent on war. But he was against it only because the Albanians had no arms and, until 1997, no way to get them.

When the Croats fought the Serbs in the early 1990s they tried to lure Mr Rugova into starting an uprising, a second front, which the Croats thought would weaken the Serbs. It might well have done, but Mr Rugova was having none of it. He did not want to give Mr Milosevic an excuse to drive out Kosovo's Albanians. This, of course, was exactly what the Serbian leader tried to do in 1999 during the war begun by the guerrillas of the Kosovo Liberation Army (KLA). This time, though, NATO responded by bombing the Serbs.

The coming of war took Mr Rugova by surprise. He seemed uncertain what to do. Supporters of the KLA charged him with treachery. When the bombing began he was placed under house arrest, forced to appear on television with Mr Milosevic and then sent into exile in Italy.

After the war he was slow to return; he seemed to be yesterday's man. Gradually, however, he realised his own strength. In the wake of the war many of the former KLA leaders appeared thuggish and violent. Members of Mr Rugova's party began to be assassinated and, without doing anything, he found his stock soaring once more. He seemed saintly and untainted with the suspicion of corruption.

In reality he was president only of Kosovo's Albanians and cared little for its other citizens. After the war, when ordinary Serbs and Roma were murdered and driven out by vengeful Albanians, he said nothing to defend them. It would have cost him popularity and, as he knew, the less he said the more popular he became.

Overview

Jan 26th 2006
From The Economist print edition

America's **housing market** continues to slow. Sales of existing homes, seasonally adjusted, fell by 5.7% in December from the month before. It was the third drop in as many months, leaving the rate of sales at its lowest since March 2004. Meanwhile, construction began on new houses at the (also seasonally adjusted) annual rate of 1.93m units, a drop of 8.9% from the month before.

Bond yields rose in America, as a Treasury auction of two-year notes attracted less interest than expected. The yield on ten-year Treasuries rose to 4.47% on January 25th, from 4.34% a week earlier.

The University of Michigan's index of **consumer sentiment** rose to its highest level since July.

The **euro-area** economy is maintaining momentum, but not gaining it, according to EuroCOIN, an indicator of current activity. Its reading of 0.57 in December, unchanged since October, suggests growth is slightly above its average quarterly rate of 0.5%.

But animal spirits are stirring in **Germany**. The IFO Institute's business climate index, based on a monthly survey of about 7,000 companies, this month reached its highest level since May 2000. In **France** INSEE's index of business sentiment was unchanged for the third month in a row. Italian consumers are less sanguine. ISAE, an Italian research institute, recorded a second monthly fall in consumer spirits.

Inflation in the euro area appears to be easing. Consumer prices rose by 2.2% in the year to December, slightly down from 2.3% in the year to November. Spain had the highest annual inflation, at 3.7%.

The euro area's **exports** to the rest of the world grew by 11% in the year to November. But its **imports** grew by 16% over the same period, leaving the single-currency zone with a narrow November deficit of €2.3 billion ($2.7 billion) in its goods trade.

Britain's GDP grew by 0.6% in the fourth quarter, thanks mainly to an acceleration in the output of services. The volume of retail sales grew by 4.0% in the year to December.

Monetary policy is tightening in **Canada** and **Sweden**. Their central banks both raised benchmark interest rates by a quarter-point, to 3.5% in Canada and 1.75% in Sweden.

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Output, demand and jobs

Jan 26th 2006
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate	
	latest	qtr*	2005	2006	latest		latest		latest	year ago
Australia	+ 2.6 Q3	+ 0.6	+ 2.7	+ 3.2	+ 1.3	Q3	+ 1.2	Q3	5.1 Dec	5.1
Austria	+ 1.8 Q3	+ 2.3	+ 1.8	+ 2.0	+ 3.0	Oct	+ 1.3	Oct	5.3 Dec	5.0
Belgium	+ 1.1 Q3	+ 1.7	+ 1.4	+ 1.9	– 1.2	Nov	+ 0.8	Oct	12.9 Dec†	12.8
Britain	+ 1.7 Q4	+ 2.4	+ 1.7	+ 2.1	– 2.4	Nov	+ 4.0	Dec	5.0 Nov††	4.7
Canada	+ 2.8 Q3	+ 3.6	+ 2.9	+ 3.1	+ 1.7	Oct	+ 2.5	Oct	6.5 Dec	7.0
Denmark	+ 4.8 Q3	+ 5.7	+ 3.0	+ 2.8	+ 2.9	Nov	+ 3.5	Nov	5.1 Dec	6.1
France	+ 1.8 Q3	+ 2.8	+ 1.5	+ 1.9	+ 1.3	Nov	+ 0.5	Nov	9.6 Nov	10.0
Germany	+ 1.4 Q3	+ 2.5	+ 1.1	+ 1.7	+ 4.7	Nov	– 0.6	Nov	11.2 Dec§	10.8
Italy	+ 0.1 Q3	+ 1.1	+ 0.2	+ 1.3	+ 0.4	Nov	+ 0.4	Oct	7.5 Sep	7.9
Japan	+ 2.9 Q3	+ 1.0	+ 2.5	+ 2.4	+ 3.4	Nov	+ 0.9	Nov	4.6 Nov	4.6
Netherlands	+ 1.3 Q3	+ 2.5	+ 0.8	+ 1.9	+ 0.4	Nov	+ 3.5	Oct	6.3 Dec**	6.7
Spain	+ 3.5 Q3	+ 3.3	+ 3.4	+ 3.0	+ 0.8	Nov	+ 0.1	Nov	8.5 Nov	10.5
Sweden	+ 3.4 Q3	+ 3.9	+ 2.6	+ 3.1	+ 1.0	Nov	+10.7	Dec	5.4 Dec†	5.3
Switzerland	+ 2.3 Q3	+ 4.3	+ 1.8	+ 2.1	+ 2.8	Q3	+ 2.8	Oct	3.8 Dec†	4.0
United States	+ 3.6 Q3	+ 4.1	+ 3.6	+ 3.3	+ 2.8	Dec	+ 4.4	Nov	4.9 Dec	5.4
Euro area	+ 1.6 Q3	+ 2.6	+ 1.4	+ 1.9	+ 2.6	Nov	+ 0.3	Nov	8.3 Nov	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*									
Finland	+ 1.9 Q3	+12.1	na	na	– 3.4	Nov	+ 5.1	Nov	8.4 Dec	8.6
Greece	+ 3.8 Q3	na	na	na	+ 0.9	Nov	+ 2.6	Oct	9.7 Q3	10.1
Iceland	+ 4.0 Q3	na	na	na	na		na		1.5 Nov†	2.6
Ireland	+ 4.8 Q3	+ 1.3	na	na	+14.8	Nov	+ 3.9	Nov	4.3 Dec	4.3
Luxembourg	+ 3.1 Q1	na	na	na	+ 3.3	Oct	– 2.9	Nov	4.9 Nov	4.4
New Zealand	+ 2.0 Q3	+ 0.2	na	na	– 2.7	Q3	+ 4.9	Q3	3.4 Q3	3.8
Norway	+ 3.1 Q3	+ 3.2	na	na	+ 1.0	Nov	+ 3.8	Nov	4.6 Nov**	4.5
Portugal	+ 0.2 Q3	– 3.7	na	na	+ 0.5	Nov	+ 1.1	Nov	7.7 Q3†	6.8

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Sep-Nov; claimant count rate 2.9% in Dec.
§EU harmonised rate 9.3% in Nov. **Oct-Dec. ‡Sep-Nov.

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Prices and wages

Jan 26th 2006
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2005	The Economist poll consumer prices forecast 2006	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.8	+ 2.9	+ 4.8	Q4	+ 8.2	+ 6.1	Q3	+ 3.5
Austria	+ 1.6	Dec	+ 2.9	+ 2.3	+ 1.9	+ 1.4	Dec	+ 5.2	+ 2.4	Dec	+ 2.0
Belgium	+ 2.9	Dec	+ 2.3	+ 2.5	+ 2.1	+ 1.7	Nov	+ 5.6	+ 2.3	Oct	+ 2.4
Britain	+ 2.0	Dec*	+ 1.6	+ 2.1	+ 2.0	+ 2.4	Dec	+ 2.9	+ 3.4	Nov†	+ 4.3
Canada	+ 2.2	Dec	+ 2.1	+ 2.3	+ 2.3	+ 2.9	Nov	+ 3.8	+ 2.8	Oct	+ 2.0
Denmark	+ 2.2	Dec	+ 1.2	+ 1.8	+ 1.9	+ 4.6	Dec	+ 2.7	+ 2.8	Q3	+ 2.9
France	+ 1.5	Dec	+ 2.1	+ 1.9	+ 1.7	+ 2.8	Nov	+ 3.2	+ 3.2	Q3	+ 2.9
Germany	+ 2.1	Jan	+ 1.6	+ 2.0	+ 1.7	+ 2.4	Dec	+ 3.8	+ 1.0	Oct	+ 2.3
Italy	+ 2.0	Dec	+ 2.0	+ 2.1	+ 2.1	+ 3.7	Nov	+ 4.3	+ 3.0	Nov	+ 2.7
Japan	– 0.8	Nov	+ 0.8	– 0.2	+ 0.3	+ 2.2	Dec	+ 1.9	– 0.3	Nov	+ 3.5
Netherlands	+ 2.0	Dec	+ 1.2	+ 1.5	+ 1.5	+ 4.5	Nov	+ 5.7	+ 1.1	Dec	+ 0.7
Spain	+ 3.7	Dec	+ 3.2	+ 3.4	+ 3.1	+ 5.2	Dec	+ 5.0	+ 1.9	Q3	+ 2.2
Sweden	+ 0.9	Dec	+ 0.4	+ 0.5	+ 1.5	+ 6.4	Dec	+ 2.0	+ 3.1	Oct	+ 3.8
Switzerland	+ 1.0	Dec	+ 1.3	+ 1.2	+ 1.1	+ 1.1	Dec	+ 1.7	+ 0.9	2004	+ 1.4
United States	+ 3.4	Dec	+ 3.3	+ 3.4	+ 2.9	+ 5.7	Dec	+ 4.4	+ 3.1	Dec	+ 2.6
Euro area	+ 2.2	Dec	+ 2.4	+ 2.2	+ 2.0	+ 4.2	Nov	+ 3.7	+ 2.2	Q3	+ 1.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.0	Dec	+ 0.4	na	na	+ 5.2	Dec	+ 0.7	+ 3.6	Q3	+ 4.0
Greece	+ 3.6	Dec	+ 3.1	na	na	+ 6.5	Nov	+ 4.0	na		na
Iceland	+ 4.4	Jan	+ 4.0	na	na	+ 3.9	Dec	+ 5.9	+ 7.2	Dec	+ 6.0
Ireland	+ 2.5	Dec	+ 2.6	na	na	+ 3.5	Nov	– 1.6	+ 3.5	Q3	+ 4.7
Luxembourg	+ 2.5	Dec	+ 2.2	na	na	+ 1.9	Nov	+15.6	+ 2.7	Sep	– 0.1
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.1	Q3	+ 2.5	+ 3.0	Q3	+ 2.2
Norway	+ 1.8	Dec	+ 1.1	na	na	+24.3	Dec	+ 9.7	+ 2.6	Q3	+ 4.3
Portugal	+ 2.6	Dec	+ 2.5	na	na	+ 3.4	Nov	+ 5.2	+ 1.2	Nov	+ 0.5

*RPI inflation rate 2.2% in Dec. †Sep-Nov.

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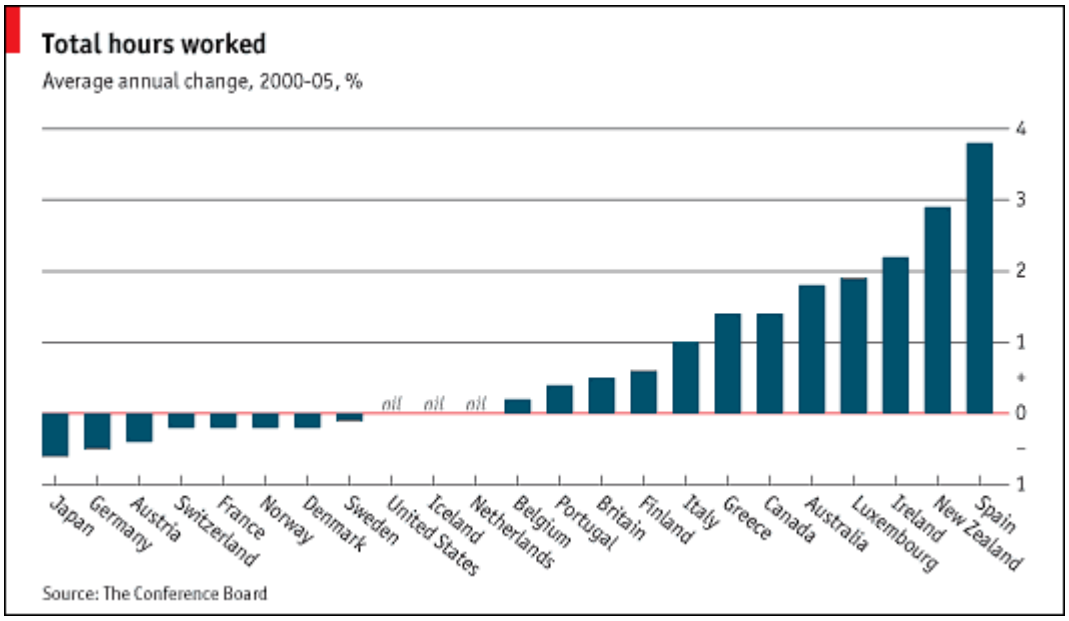
Total hours worked

Jan 26th 2006
From The Economist print edition

Spain's economic growth stems from industriousness, not ingenuity, according to a study by the Conference Board. Total hours worked rose by an annual average of 3.8% in 2000-05. Labour productivity, or output per hour, fell by an annual average of 0.6%. By contrast, Ireland's growth came from both sources, with labour productivity rising by an annual average of 3.0% and hours worked increasing by an average of 2.2%.



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Money and interest rates

Jan 26th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Jan 25th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.6	+ 8.7	Nov	5.64	5.41	5.21	5.25	5.35	6.24
Britain	+ 5.0	+12.6	Dec	4.53	4.81	4.30	4.08	4.59	5.14
Canada	+ 9.3	+ 8.4	Nov	3.47	2.43	3.83	4.15	4.29	5.14
Denmark	+19.2	+12.2	Nov	2.55	2.25	2.88	3.37	3.66	4.95
Japan	+ 5.5	+ 2.0	Dec	0.03	0.02	0.24	1.45	1.34	1.66
Sweden	+ 2.7	+ 7.2	Nov	1.85	1.98	2.48	3.31	3.65	3.29
Switzerland	+ 5.4	+ 5.6	Dec	0.94	0.75	1.51	2.11	2.12	2.45
United States	- 0.1	+ 7.8	Dec	4.23	2.56	4.46	4.47	4.19	5.38
Euro area†	+10.6	+ 7.6	Nov	2.53	2.14	2.90	3.40	3.53	3.87

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.65%, Japan No. 275 1.46%. Central bank rates: US fed funds 4.25%, ECB refinancing 2.25%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 26th 2006
From The Economist print edition

2000=100

	Jan 17th	Jan 24th*	% change on one month	% change on one year
Dollar index				
All items	150.1	152.4	+ 4.2	+21.6
Food	132.4	134.0	+ 2.0	+13.5
Industrials				
All	173.0	176.1	+ 6.5	+30.7
Nfa†	143.2	147.3	+ 6.5	+18.6
Metals	189.2	191.8	+ 6.5	+36.5
Sterling index				
All items	129.4	129.5	+ 1.1	+27.0
Euro index				
All items	115.0	114.8	+ 0.7	+28.3
Yen index				
All items	161.3	162.1	+ 2.1	+33.9
Gold				
$ per oz	558.80	556.90	+11.0	+31.5
West Texas Intermediate				
$ per barrel	66.34	67.00	+15.6	+35.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jan 26th 2006
From The Economist print edition

Market indices

	Jan 25th	2005-06 high	2005-06 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,812.0	4,817.3	3,905.5	+ 1.5	- 0.1	+18.7	+13.9
Austria (ATX)	3,881.6	3,881.6	2,415.0	+ 3.0	nil	+59.6	+44.0
Belgium (Bel 20)	3,682.4	3,691.1	2,958.8	+ 1.2	- 0.2	+25.6	+13.3
Britain (FTSE 100)	5,704.4	5,740.2	4,783.6	+ 0.7	-17.7	+18.5	+10.3
Canada (Toronto Composite)	11,675.2	11,733.4	9,006.2	+ 1.0	- 0.5	+26.3	+31.7
Denmark (OMXCB)	366.1	374.2	257.8	+ 0.4	- 2.2	+42.0	+27.7
France (SBF 250)	3,372.0	3,429.0	2,633.6	+ 0.5	-23.2	+28.0	+15.5
(CAC 40)	4,791.0	4,890.5	3,816.1	+ 0.4	-30.8	+25.4	+13.1
Germany (DAX)*	5,427.1	5,542.1	4,178.1	+ 0.6	-32.7	+27.5	+15.0
Italy (S&P/MIB)	35,929.0	36,661.0	30,645.0	- 0.3	-28.3	+16.3	+ 4.9
Japan (Nikkei 225)	15,651.0	16,455.0	10,825.4	+ 2.0	-59.8	+36.2	+20.6
(Topix)	1,618.5	1,685.2	1,109.2	+ 2.8	-43.9	+40.8	+24.6
Netherlands (AEX)	436.5	447.9	347.0	+ 0.5	-37.8	+25.4	+13.1
Spain (Madrid SE)	1,172.8	1,184.1	950.9	+ 1.1	- 1.0	+22.3	+10.3
Sweden (Affarsvarlden Gen)	289.8	299.4	218.9	+ 0.2	-27.6	+31.0	+15.2
Switzerland (Swiss Market)	7,682.7	7,835.7	5,669.6	- 0.6	- 8.7	+34.9	+21.6
United States (DJIA)	10,709.7	11,043.4	10,012.4	- 1.3	- 8.6	- 0.7	- 0.7
(S&P 500)	1,264.7	1,294.2	1,137.5	- 1.0	-17.2	+ 4.4	+ 4.4
(NASDAQ Comp)	2,260.7	2,331.4	1,904.2	- 0.8	-55.2	+ 3.9	+ 3.9
Europe (FTSEurofirst 300)†	1,291.2	1,311.9	1,038.6	+ 0.5	-24.3	+23.9	+11.8
Euro area (FTSE Euro 100)†	1,091.9	1,117.1	894.4	+ 0.4	-29.6	+21.2	+ 9.3
World (MSCI)‡	1,291.1	1,311.6	1,115.0	+ 0.5	-10.9	+10.4	+10.4
World bond market (Citigroup)††	634.9	662.3	608.7	nil	- 4.1	- 4.7	- 4.7

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jan 26th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Jan 25th	year ago	Currency units per $ Jan 25th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 15.0	Nov	− 43.5	Q3	− 5.9	− 5.3	117.8	114.1	1.33	1.29	2.38	1.63	1.15	+ 1.0
Austria	− 1.8	Oct	− 0.4	Nov	nil	− 0.1	103.7§	104.7	0.82	0.77	1.46	–	0.70	− 2.0
Belgium	+ 14.2	Nov	+ 8.2	Sep	+ 2.2	+ 2.2	104.1§	105.6	0.82	0.77	1.46	–	0.70	nil
Britain	−116.9	Nov	− 40.6	Q3	− 2.1	− 2.2	98.6	99.5	0.56	0.53	–	0.69	0.48	− 3.1
Canada	+ 52.7	Nov	+ 19.6	Q3	+ 1.8	+ 1.6	125.9	116.2	1.15	1.23	2.05	1.41	0.99	+ 1.3
Denmark	+ 9.2	Nov	+ 8.7	Nov	+ 2.9	+ 2.8	106.0	106.6	6.09	5.69	10.9	7.46	5.26	+ 2.8
France	− 31.6	Nov	− 34.6	Nov	− 1.2	− 1.0	106.6§	108.3	0.82	0.77	1.46	–	0.70	− 3.2
Germany	+203.6	Nov	+114.0	Nov	+ 3.9	+ 3.8	104.3§	106.2	0.82	0.77	1.46	–	0.70	− 3.9
Italy	− 11.8	Nov	− 28.3	Oct	− 1.5	− 1.4	76.3§	77.5	0.82	0.77	1.46	–	0.70	− 4.3
Japan	+ 97.6	Nov	+164.7	Nov	+ 3.5	+ 3.4	82.3	90.3	116	103	207	142	–	− 6.5
Netherlands	+ 39.3	Nov	+ 44.3	Q3	+ 4.1	+ 4.2	103.6§	105.1	0.82	0.77	1.46	–	0.70	− 1.6
Spain	− 95.2	Oct	− 80.8	Sep	− 6.5	− 6.8	77.1§	77.9	0.82	0.77	1.46	–	0.70	+ 0.3
Sweden	+ 19.3	Dec	+ 24.2	Q3	+ 7.0	+ 6.7	97.3	100.2	7.55	6.94	13.5	9.26	6.53	+ 1.2
Switzerland	+ 6.4	Nov	+ 49.3	Q3	+13.3	+12.7	107.1	107.6	1.26	1.18	2.26	1.55	1.09	− 1.6
United States	−772.7	Nov	−780.6	Q3	− 6.5	− 6.6	85.4	81.5	–	–	1.79	1.23	0.86	− 3.7
Euro area	+ 35.9	Nov	− 26.3	Nov	nil	nil	116.9	118.5	0.82	0.77	1.46	–	0.70	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.4	Nov	+ 6.8	Nov	na	na	81.4§	82.3	0.82	0.77	1.46	–	0.70	+ 2.1
Greece	− 34.3	Oct	− 17.0	Nov	na	na	59.8§	60.4	0.82	0.77	1.46	–	0.70	− 4.5
Iceland	− 1.5	Nov	− 2.2	Q3	na	na	109.9**	96.1	61.2	62.4	109	75.0	52.9	+ 2.0
Ireland	+ 40.6	Nov	− 3.7	Q3	na	na	93.6§	96.2	0.82	0.77	1.46	–	0.70	− 0.9
Luxembourg	− 4.6	Oct	+ 3.5	Q3	na	na	104.1§	105.6	0.82	0.77	1.46	–	0.70	− 2.3
New Zealand	− 4.6	Nov	− 9.1	Q3	na	na	135.8	134.5	1.46	1.39	2.61	1.79	1.26	+ 5.3
Norway	+ 47.8	Dec	+ 43.7	Q3	na	na	108.9	106.2	6.55	6.32	11.7	8.03	5.66	+ 15.3
Portugal	− 23.3	Oct	− 16.7	Nov	na	na	93.7**	93.7	0.82	0.77	1.46	–	0.70	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD estimate.
**IMF, September average.

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Hedge-fund performance

Jan 26th 2006
From The Economist print edition

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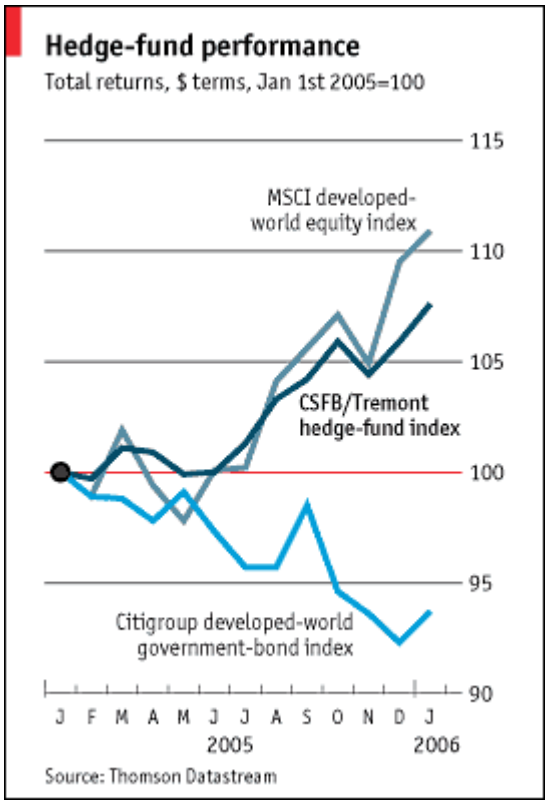

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Overview

Jan 26th 2006
From The Economist print edition

In **China** GDP grew by 9.9% in the year to the fourth quarter. Industrial production rose by 16.5% in the 12 months to December.

South Korea's growth in **GDP** quickened to 5.2% in the year to the fourth quarter. Industrial production in **Taiwan** rose by 9.5% in the 12 months to December.

In **Singapore** inflation rose to 1.3% in the year to December. The 12-month trade surplus widened to $29.6 billion in December.

Industrial-production growth slackened in **Russia** to 4.6% in the 12 months to December. In **Poland** it picked up to 9.2% over the same period. In **Israel** it recovered to 3.5% in the 12 months to November.

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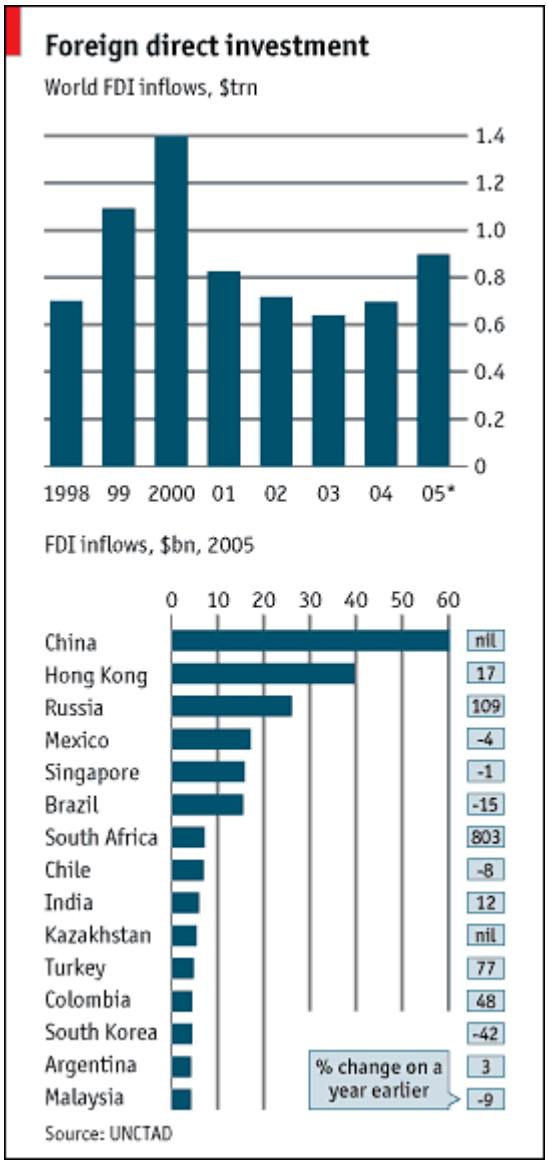
Foreign direct investment

Jan 26th 2006
From The Economist print edition

Inflows of foreign direct investment grew by 29% in 2005 to reach almost $900 billion. FDI to developed countries jumped by 38%, although this was distorted by the merger of Royal Dutch and Shell. Inflows to developing countries rose by a more modest 13%, but reached their highest level on record. For the first time since 1999, there was no growth in FDI to China, the biggest recipient among developing countries.



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Economy

Jan 26th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.5	Dec	+ 1.6	Dec	+102.1	Dec	+128.5	H1	818.9	Dec
Hong Kong	+ 8.2	Q3	+ 4.1	Q3	+ 1.8	Dec	−10.5	Dec	+21.0	Q3	124.3	Dec
India	+ 8.0	Q3	+ 6.9	Nov	+ 5.3	Nov	−37.3	Dec	−18.3	Q3	131.0	Dec
Indonesia	+ 5.3	Q3	+11.3	Nov	+17.1	Dec	+26.2	Nov	+ 0.7	Q3	31.7	Nov
Malaysia	+ 5.3	Q3	+ 6.7	Nov	+ 3.5	Dec	+25.6	Nov	+18.7	Q3	72.5	Nov
Pakistan	+ 8.4	2005†	+11.0	Jun	+ 8.5	Dec	− 9.3	Dec	− 3.7	Q3	9.6	Nov
Philippines	+ 4.1	Q3	+ 4.6	Oct	+ 6.6	Dec	− 2.6	Nov	+ 2.9	Sep	15.8	Dec
Singapore	+ 7.7	Q4	+ 5.1	Dec	+ 1.3	Dec	+29.6	Dec	+33.7	Q3	116.6	Dec
South Korea	+ 5.2	Q4	+12.2	Nov	+ 2.6	Dec	+23.5	Dec	+16.6	Dec	210.4	Dec
Taiwan	+ 4.4	Q3	+ 9.5	Dec	+ 2.2	Dec	+ 7.8	Dec	+ 8.9	Q3	253.3	Dec
Thailand	+ 5.3	Q3	+ 5.0	Nov	+ 5.8	Dec	− 8.0	Nov	− 3.2	Nov	49.4	Nov
Argentina	+ 9.2	Q3	+ 7.9	Dec	+12.3	Dec	+11.1	Nov	+ 4.4	Q3	25.7	Nov
Brazil	+ 1.0	Q3	+ 0.6	Nov	+ 5.7	Dec	+44.8	Dec	+14.9	Nov	64.3	Nov
Chile	+ 5.2	Q3	+ 6.2	Nov	+ 3.7	Dec	+ 9.2	Dec	− 0.2	Q3	17.0	Dec
Colombia	+ 5.8	Q3	+ 0.5	Oct	+ 4.9	Dec	+ 1.5	Oct	− 1.7	Q3	14.8	Dec
Mexico	+ 3.3	Q3	+ 3.0	Nov	+ 3.3	Dec	− 7.6	Dec	− 8.4	Q3	72.7	Nov
Peru	+ 7.9	Nov	+ 7.6	Nov	+ 1.5	Dec	+ 4.6	Nov	+ 0.8	Q3	13.2	Dec
Venezuela	+ 9.8	Q3	+10.8	Oct	+14.4	Dec	+28.2	Q3	+21.6	Q3	24.4	Oct
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.4	Nov	−11.3	Q3	+ 1.8	Q3	20.9	Dec
Israel	+ 5.7	Q3	+ 3.5	Nov	+ 2.4	Dec	− 7.9	Dec	+ 2.4	Q3	27.9	Dec
Saudi Arabia	+ 6.2	2005‡	na		+ 1.0	Sep	+84.6	2004	+51.9	2004	27.6	Nov
South Africa	+ 4.9	Q3	+ 3.7	Nov	+ 3.6	Dec	− 3.4	Nov	−10.3	Q3	18.6	Dec
Czech Republic	+ 4.9	Q3	+ 7.2	Nov	+ 2.2	Dec	+ 1.5	Nov	− 3.4	Q3	29.3	Dec
Hungary	+ 4.5	Q3	+ 7.7	Nov	+ 3.3	Dec	− 3.5	Nov	− 8.7	Q3	17.5	Dec
Poland	+ 3.7	Q3	+ 9.2	Dec	+ 0.7	Dec	− 3.1	Nov	− 4.9	Nov	39.8	Dec
Russia	+ 7.0	Q3	+ 4.6	Dec	+10.9	Dec	+117.6	Nov	+81.2	Q3	175.9	Dec
Turkey	+ 7.0	Q3	+10.7	Nov	+ 7.7	Dec	−43.2	Nov	−21.7	Nov	47.9	Nov
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.8	Q3	+10.4	Nov	+ 3.6	Dec	− 2.5	Oct	− 1.4	Nov	1.8	Nov
Latvia	+11.4	Q3	+ 5.9	Nov	+ 7.0	Dec	− 2.9	Nov	− 1.9	Nov	2.2	Nov
Lithuania	+ 7.6	Q3	na		+ 3.0	Dec	− 3.6	Nov	− 1.7	Nov	3.5	Nov
Slovakia	+ 6.2	Q3	+ 5.7	Nov	+ 3.7	Dec	− 1.9	Nov	− 2.8	Sep	14.9	Nov
Slovenia	+ 3.7	Q3	+ 7.3	Nov	+ 2.3	Dec	− 1.6	Nov	+ 0.1	Nov	8.0	Oct

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Financial markets

Jan 26th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 25th		Dec 31st 2004	
	Jan 25th	year ago	Jan 25th	% a year		one week	in local currency	in $ terms
China	8.06	8.28	14.4	2.50	1,318.9	+1.9	– 0.8	+ 1.8
Hong Kong	7.76	7.80	13.9	3.94	15,520.4	+0.3	+ 9.1	+ 9.3
India	44.1	43.7	78.8	6.17	9,685.7	+4.9	+ 46.7	+ 44.6
Indonesia	9,343	9,142	16,698	14..1	1,230.1	+3.1	+ 23.0	+ 22.2
Malaysia	3.75	3.80	6.70	3.27	909.8	+0.9	+ 0.3	+ 1.7
Pakistan	59.8	59.3	106.94	8.96	10,214.0	–0.2	+ 64.3	+ 63.0
Philippines	52.5	55.3	93.8	7.31	2,112.5	–0.6	+ 15.9	+ 23.9
Singapore	1.62	1.63	2.90	3.28	2,378.6	+0.8	+ 15.1	+ 15.9
South Korea	969	1,032	1,731	4.16	1,342.6	–0.8	+ 49.9	+ 60.1
Taiwan	32.0	31.8	57.1	1.65	6,532.2	+0.5	+ 6.4	+ 5.5
Thailand	39.1	38.5	69.8	4.60	762.7	+3.6	+ 14.2	+ 13.5
Argentina	3.04	2.92	5.44	9.06	1,708.4	+3.8	+ 24.2	+ 21.3
Brazil	2.25	2.67	4.01	17.20	37,399.0	+4.5	+ 42.8	+ 68.9
Chile	527	585	942	5.04	9,366.9	+0.4	+ 4.5	+ 10.2
Colombia	2,273	2,371	4,063	6.12	11,149.7	+4.7	+156.6	+165.5
Mexico	10.5	11.3	18.8	7.73	18,866.4	+3.3	+ 46.0	+ 55.0
Peru	3.35	3.26	5.98	3.60	5,201.0	+6.1	+ 40.2	+ 37.4
Venezuela	2,735§	2,751§	4,888	11.46	24,447.8	+0.5	– 18.4	– 23.0
Egypt	5.73	5.86	10.25	8.54	64,466.0	+3.7	+162.2	+177.6
Israel	4.60	4.41	8.22	4.91	872.0	+3.0	+ 35.4	+ 27.2
Saudi Arabia	3.75	3.75	6.70	5.16	18,680.3	+5.9	+127.6	+127.6
South Africa	6.04	5.95	10.8	7.15	19,262.4	+5.2	+ 52.2	+ 42.1
Czech Republic	23.1	23.0	41.4	2.09	1,529.2	+2.1	+ 48.2	+ 43.0
Hungary	203	188	363	6.10	22,350.2	+1.0	+ 51.6	+ 34.8
Poland	3.11	3.11	5.55	4.43	39,351.6	+4.0	+ 47.7	+ 42.4
Russia	27.9	28.0	50.0	12.00	1,324.7‡	+7.3	+117.5	+115.7
Turkey	1.32	1.35	2.37	14.73	45,746.2	+7.3	+ 83.2	+ 86.5
EM (MSCI)*	1.00	1.00	1.79	na	769.9	+4.2	+ 42.0	+ 42.0
EMBI+†	1.00	1.00	1.79	na	375.1	+0.7	+ 13.8	+ 13.8

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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